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FIRST CONCURRENT RESOLUTION ON THE BUDGET—FISCAL YEAR 1983

Y4.B85/2:C74/983/v.3

ORIGINAL
COMPLETED

HEARINGS

BEFORE THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

NINETY-SEVENTH CONGRESS

SECOND SESSION

MARCH 10, 1982—USER FEES
MARCH 16, 1982—CONTROLLABILITY OF ENTITLEMENTS
MARCH 17, 1982—TAX EXPENDITURES

Volume III

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USER FEES

WEDNESDAY, MARCH 10, 1982

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The committee met, pursuant to notice, at 10:17 a.m., in room 6202, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman of the committee) presiding.

Present: Senators Domenici, Boschwitz, Andrews, Symms, and Gorton.

Staff present: Stephen Bell, staff director; Charles Riemenschneider, senior analyst for physical resources; Lizabeth Tankersley, minority staff director; and Byron Waldman, analyst for transportation.

Chairman DOMENICI. The hearing will please come to order. We have a hearing on user fees today. Basically, we have three witnesses planned: Dr. Rivlin; John Fowler, General Counsel for the Department of Transportation; and Lester Lave, Senior Fellow at the Brookings Institution.

Dr. Rivlin, you have two associates that you want to testify or to be available?

Dr. RIVLIN. No, not necessarily; they can be available. We can arrange this any way you want.

Chairman DOMENICI. I think we probably ought to have all three witnesses at the table.

Dr. RIVLIN. Fine.

Chairman DOMENICI. We do not want them to leave.

Dr. RIVLIN. That is fine. Why do we not just do it as a panel of three witnesses?

Chairman DOMENICI. All right, can we have John Fowler and Lester Lave?

Mr. FOWLER. Senator, if I might, I have Mr. Swinburn with me, who is more atuned to waterways than am I, and I wondered if he might join me on the panel.

Chairman DOMENICI. Indeed.

OPENING STATEMENT OF CHAIRMAN DOMENICI

I have some prepared remarks, which I will not read, but will insert in the record. Senator Boschwitz very much wants me to deliver them, since he wants to disagree with them. But I think that since he has had a chance to read them, I will not do that; I will just let him argue with them.

USER FEES HAVE NO CONSTITUENCY

Basically, the thrust of it is that user fees have no constituency, yet they make eminent sense in terms of whether it is transportation or seaport construction and maintenance or airports. It is obvious that the general taxpayers of this nation have been paying substantial amounts of money for those kinds of facilities or government functions.

It is not a recent innovation for the executive branch of government to ask for user fees. Perhaps Dr. Rivlin can correct me, but user fees were first suggested by President Franklin Roosevelt, and have been requested by every President since then.

Senator Boschwitz. Are you suggesting that Mrs. Rivlin was here at that time?

Chairman Domenici. No; I am suggesting that she is a historian.

Senator Boschwitz. Oh, I see.

Dr. Rivlin. Thank you, Senator. [Laughter.]

Chairman Domenici. But just to show you that it is bipartisan, that request has continued with every President since. I think Eisenhower asked for them, Truman asked for them, Ford asked for them, Jimmy Carter asked for them. Lyndon Johnson was probably too busy.

But we did make a little headway into the field of inland waterways a couple of years ago with the imposition of the first tax on fuel used by inland barges. I hope Dr. Rivlin and the other witnesses will describe the portion of the government's cost for inland waterways which will be recovered from that fuel tax, which has not yet reached its maximum of 10 cents.

It is obvious that the President relies significantly on the imposition of user fees, wherever they are clearly definable. In not only his fiscal budget, but also in his philosophical budget. He did that last year; but Congress did not respond significantly. I am personally hopeful that we will get some user fees this year, but I do not think that is probable. I think some of them might occur, but certainly not the whole package as the president recommends.

With that, Senator Boschwitz, I know you have an interest on this subject. I will yield to you and then we will go to the witnesses.

PREPARED STATEMENT OF CHAIRMAN DOMENICI

I am delighted to welcome our witnesses today: Dr. Alice Rivlin, Director of the Congressional Budget Office, John Fowler, General Counsel of the Department of Transportation, and Dr. Lester Lave of the Brookings Institution.

The topic of today's hearing, user fees, has long been a subject of my own personal interest. Some of you may remember the bill I sponsored several years ago which eventually was enacted and imposed a graduated fuel tax on users of our inland waterway system. You may also remember the significant opposition that had to be overcome to get that bill through Congress.

The issue of user charges is one that lacks any real constituency, other than believers in the principals of sound government. The barge companies hate it, the farmers hate it, the coal companies and the steel companies all lobby hard against it. Anyone who has been enjoying a Federal subsidy without interruption for years is against these proposals.

Reduced to its simplest terms, it is a question of equity. There is little reason for the Government to provide an indirect subsidy to a particular user group, simply by not charging for a service or facility provided by the Federal Government. Simple equity demands user fees sooner or later, and the sooner they are instituted, the sooner the inequity which now exists will be rectified.

The issue has been studied ad nauseum. Over the past 10 years, almost 20 studies have been done on the waterway transportation issue alone. Inevitably, these studies have concluded that the imposition of user charges is a reasonable, equitable approach to Federal cost recovery and, in addition, that the ultimate effect on consumers is minimal.

ECONOMISTS SUPPORT WATERWAY USER CHARGES

In the case of waterway user charges, there is one group of experts that appears unanimous in its view that user charges are essential for effective transportation balance. These experts are the economists. It is very difficult to find an economist who does not support waterway user charges. During the debate of the 1978 inland waterway bill, I received a letter supporting my proposal signed by more than 100 economists. Given the nature of economists and their propensity toward disagreement, I think that that, in and of itself, is significant.

Today's hearing will address user fees in a number of Federal programs, using the administration's proposals as a focus. As part of the fiscal year 1983 budget request, the administration has proposed user fees in a wide range of Federal programs, ranging from transportation and housing, to recreation and Army Corps of Engineers water programs. While I might differ on the specifics of the administration's various proposals, I am supportive of their underlying philosophy. It is a difficult concept to dispute. As a matter of fact, every administration since Franklin D. Roosevelt has supported the concept of user fees.

When Secretary Lewis appeared before the Senate Committee on Environment and Public Works, I asked a very pointed question. I asked how committed this administration is to its user fee legislation package. I asked that question for a good reason. I remember all too clearly what a fight it was to get the inland waterway bill through Congress. The administration's current proposals take on not only the barge and other related waterway industries, but also the housing industry, users of national parks and recreation areas, veterans, and the aviation and marine communities—just to name a few. Success of the administration's comprehensive proposals will involve not just one or two committees, but a good number of them. Getting these proposals through the Congress and signed into law will require a serious, active commitment on the part of the administration, and even then it will be difficult.

I hope that that commitment is there, and I will assist in whatever way I can. I look forward to the remarks which will be made on this subject by our distinguished witnesses.

OPENING STATEMENT OF SENATOR BOSCHWITZ

Senator BOSCHWITZ. Mr. Chairman, I do not agree with the presumption that user fees are correct. It is a function of Government to provide many services. To say that all these services should be retrieved in some way, whether it be a food stamp program for individuals or other programs directed at individuals or elsewhere—they are all forms of user fees.

I would suppose that in New Mexico there is considerable irrigation, and that is certainly an expense that is not well recovered. I think Mrs. Rivlin addresses that issue in her testimony.

I also believe that port and river charges that would be unique to this country; they are not found in other countries. Our competitive situation would certainly not be enhanced if producers found themselves in the position of paying user fees or charges that often are far more than they need to be or ought to be, particularly in rivers.

This country, which had last year a $26 billion agricultural trade surplus, really is an extraordinary country with respect to its climate and soil, and also with respect to the fact that it is bisected by the greatest commercially used river system in the world. To undermine our ability to make these types of exports would be very harmful indeed.

I look forward to the testimony and to being part of the constituency against certain user fees, perhaps all user fees, unless there is an effort made to obtain a broader definition of user fees.

WATERWAYS EFFECTIVENESS NOT DIMINISHED BY USER FEES

Chairman DOMENICI. Thank you very much, Senator Boschwitz.

I want the record to reflect that this Senator is fully aware of the miracle of the inland water system of America and of its port system. If I thought for 1 minute that the imposition of reasonable user fees would either diminish the effectiveness of those waterways and the transportation system overall or significantly impede our ability to engage in world commerce, I would stand squarely behind Senator Boschwitz.

My research has indicated quite to the contrary, especially with reference to so-called deep ports. It is amazing how we all want to build five or six new deep water ports quickly and get the Corps of Engineers to go out there and do it. Then, we had a market economist testify before the Environment and Public Works Committee and ask us: "How are you going to know which one is the right one, since everyone wants them?"

He made a very simple suggestion that would normally be very exciting to my good friend, Senator Boschwitz. He said, "Why do you not let the marketplace decide?" It turned out that the committee continued its deliberations and found that if you required recoupment of Federal costs by the ports of this country, they would probably pick one or two. The committee also found that if we could get rid of the delays environmental assessments and the like impose, we would probably build one or two quickly and, lo and behold, it seems that they would be exactly in the right place because supply and demand would dictate where they ought to be.

That is what the Committee on Public Works did, and I think it is going to work if Congress ever gets around to passing the bill that is on the floor which would permit a small recoupment for maintenance of the ports, and impose on them the mandate that they recover a portion of the capital costs to build the deep ports. I think the same would ultimately apply to the inland waterways.

AMOUNT OF MONEY TO BE SPENT ON WATERWAYS IS GOING DOWN

I would say this to my good friend in closing: if you look at the history of this Nation's expenditures for waterways and water projects, you will end up aghast at the fact that the amount of money that Congress has been willing to spend for water issues is not going up, but going down dramatically. Furthermore, there is not broad-based support for turning that trend line upward.

That bothers me not because of my State and not because of the West, but because we seem to have only parochial, regional enthusiasm for the expenditure of water moneys. Until we take a different approach where there is broad support, the water needs of the country will be going up and the expenditures will be coming down. I am looking for some way to turn that around. It would probably mean a much different water policy for the country than spending most of its money on inland waterways, Corps of Engineer and Bureau of Reclamation projects which are located principally in about 15 or 18 out of the 50 States.

With that, we will call on Dr. Rivlin.

STATEMENT OF ALICE M. RIVLIN, DIRECTOR, CONGRESSIONAL BUDGET OFFICE

Dr. RIVLIN. Mr. Chairman, I am pleased to appear before your committee to discuss the pricing of Government services. My remarks today will concentrate on two topics: the economic rationale for increasing the fees charged for Government services; and the appropriate standards for Federal fees, first with market prices and then with full cost recovery as the benchmark.

THE ECONOMIC RATIONALE FOR USER FEES

When Federal expenditures benefit the Nation as a whole, it is appropriate that the taxpayers bear the costs. But many Federal services benefit clearly identifiable groups. In such cases, concerns with both economic efficiency and fairness suggest that these specific beneficiaries should pay for what they receive.

Under current policy, most user fees are set well below the economically appropriate levels. Increasing fees either to their market equivalent or to levels that recovered all the Government's costs would improve the long-run efficiency of the economy, could help reduce Federal deficits, and would help allocate the burden of deficit reduction in a manner generally perceived as fair.

ECONOMIC EFFICIENCY AND THE PRICING OF GOVERNMENT SERVICES

Many Federal services have counterparts in the private marketplace; examples include the Federal Reserve's collection and sorting of checks for commercial banks, the provision of grazing land, and uranium enrichment. In such cases, market prices can serve as a guide for Federal fees. Such charges would provide an incentive to use the most economic level of Government service and would correct distortions that result when one group receives low-cost Government service while another must pay the market price.

Mineral leasing offers an example of how market pricing has been applied effectively. Under current policy, production rights to offshore oil and gas properties or onshore mineral tracts are leased through sealed-bid auctions. As a result of competitive bidding, the market price paid for a mineral lease reflects its potential for production and level of risk. The competitive nature of auctioning assures that resources for mineral development will be directed toward their highest economic value. Charges of this type might also be applied to other services such as federally supplied water.

Most Federal services, however, are not amenable to market-based pricing. Among these are the services provided by Federal infrastructure investments—the roads, waterways, and other facilities that make up the physical framework of the Nation's economy. Since the market offers no equivalent for these services, an appropriate benchmark can be full recovery of the Government's cost. Fees that accomplish this would help to shift the patterns of investment toward a more efficient economic infrastructure. To the extent that users of these facilities reimbursed the Government for investments made on their behalf, they would have an incentive to work with the Government to insure that only cost-effective investments are made. Waterways, to which I will turn shortly, are an excellent example of this.

Most user fees now in effect are set well below full cost or market prices. Raising fees would improve efficiency and yield the secondary benefit of reducing net Federal expenditures. Higher user fees cannot by themselves eliminate the deficit, but they can help in two ways: by increasing revenues and by reducing outlays.

In the areas that the Congressional Budget Office [CBO] has examined for increased or altogether new user fees, Federal expenditures could be reduced by about $130 billion between 1983 and 1987. Of this sum, roughly half would be collected through fees under current law. Much of the remaining savings could be achieved by increasing the application of user fees. It should be noted, however, that these fees will be deductible as business expenses from taxes of individuals and corporations. Thus, about one-fourth of the gross revenue gained from the newly increased user fees would be offset by reduced income tax collections.

THE TRANSITION COSTS OF INCREASED USER FEES

Some transition costs necessarily accompany any move toward a more efficient economy. In the near term, higher fees might cause severe dislocations for regions and groups that have made investments on the expectation that low-cost, federally supported services would continue. Changing past commitments might, in effect, be asking these parties to bear the cost of making national economic gains. To mitigate this, increases in Federal fees could be phased in gradually, thereby easing short-run effects but not sacrificing the ultimate results.

Some inflationary effects would probably result from increased user fees, inasmuch as the increases would be passed through to consumers in the final costs of goods and services. Any such adverse effects are likely to be slight, however, and they would eventually diminish with improved economic efficiency and with reductions in interest rates that would accompany a lower deficit.

GREATER APPLICATION OF USER FEES

By way of example, I would like to give four areas closer attention: irrigation, inland waterways, deep-draft navigation, and the strategic petroleum reserve. Each of these is an important issue now before the Congress, and each illustrates both the advantages and the difficulties of increasing the price of Government services.

IRRIGATION AND WATER PRICING

At the turn of the century, the Federal Government began to subsidize the provision of water to encourage the development of the West. Eighty years later, western farmers are still receiving water at subsidized rates. These subsidies encourage wasteful use of water in regions that may no longer need subsidized development. They also distort farmers' decisions about which crops to grow. In some places, for instance, farmers with access to federally subsidized water are growing two crops that they would not otherwise raise at all: cotton and rice. Two problems result from this. First, market gluts can occur, driving the market values of those commodities downward, in turn prompting the Government to raise values artificially by means of price supports, which have Federal costs of their own. Second, regional distortions can develop. For example, subsidized irrigation water for cotton and rice in the West puts production of those crops at a competitive disadvantage in other regions—primarily in the South—where irrigation water is not subsidized. Furthermore, because of the subsidy, farmers have no incentive to invest in water-saving irrigation methods or crop choices. In fact, rice is a particulary water-intensive crop.

Under current policy, the Federal Government will invest roughly $3.8 billion from 1983 through 1987 in irrigation facilities. Of this amount, roughly $275 million would be recovered with charges now in place. If prices for new or renegotiable water contracts were raised to market levels, net receipts of as much as $1 billion might be collected from 1983 through 1987.

If all contracts could be converted to market prices immediately, this would yield roughly $16 billion over the same period. But many of these contracts run for as long as 40 years, so the rate of conversion is likely to be slow.

Raising the price of federally supplied water would improve long-term efficiency in use of this resource, but not without short-term costs. The product mix from irrigated western agriculture would change and higher priced water would raise the price of some agricultural products. At the outset, some farmers would probably respond by improving water conservation with lined delivery canals and by using better irrigation schedules and methods. As water prices increased over time, farmers could switch to crops that needed less water, probably requiring investment in new equipment. As water prices rose still higher, a reduction in water used for farm irrigation would augment the supply available for municipal or industrial customers able to pay higher prices.

INLAND WATERWAYS

Towboats using the inland waterways pay a fuel tax of 6 cents per gallon, the only fees now charged for these facilities. Under current law, this tax will rise to 10 cents per gallon in 1986. Federal expenditures for inland waterways will amount to some $3.1 billion between 1983 and 1987, of which fees at their currently scheduled rates will recover only $240 million. As a result, inland waterways are heavily subsidized. Such a policy encourages projects that are not cost-effective. It also diverts traffic from railroads or trucks to waterways; such diversion would not occur if shippers had to pay the full cost of using each mode.

Domestic inland water transportation received the highest subsidy of any freight mode in 1980—3.9 mills per ton-mile. This is well above the 2.2 mills per ton-mile received by railroads and the 1.8 mills per ton-mile received by trucks (detailed in table 1). Pipelines, which carry more ton-miles than either barges or trucks, receive no Federal capital or operating subsidies.

Present Federal subsidies for the inland waterways are particularly large relative to the total cost of moving goods. In 1980, subsidies covered more than one-fourth of the costs of all inland waterway shipping. This is more than four times the portion of shipping cost covered by rail subsidies, and almost 30 times more than truck subsidies.

TABLE 1.—COMPARISON OF FEDERAL SUBSIDIES TO FREIGHT TRANSPORTATION

Mode	Mills per ton-mile (in constant 1982 dollars)	As a percent of total cost
Truck, 1980 actual	$1.8	1.0
Railroad, 1980 actual	2.2	6.2
Inland waterway:		
Current policy, 1980	3.9	29.5
1987 administration bill	0.7	7.0
1987 Domenici amendment	1.1	10.7

Source: Congressional Budget Office.

The administration has proposed (in S. 810 and amendment No. 637) sharply increasing the fees paid by users of the Nation's inland waterways. This plan would yield about $2 billion in additional revenue over the next 5 years. A similar proposal (amendment No. 32) introduced by you, Senator Domenici, would generate about $1.3 billion in additional revenue during the same period. Both of these proposals would shift policy closer to full-cost-recovery pricing for waterways, resulting in subsidies that are comparable to those received by other modes of transportation.

Coal, soybeans, and grain would be among the commodities most affected by increasing user fees. Much of the coal goes to utilities that have been made substantial investments in coal-burning equipment. Barge operators could probably pass along most of the increased user fees to shippers, and relatively little traffic would be diverted. Ultimately, most of the fees would be passed on to consumers. Under the administration proposal, consumers in affected regions could end up paying about 1 percent more for their electricity.

Similarly, higher user fees would drive up the transportation costs for soybeans and grain. But farmers are not likely to bear this burden alone; part would also be transferred to water carriers, grain handlers, and domestic and foreign consumers. If half the cost increase implicit in the administration's proposal were borne by farmers, they would then absorb a loss of about 1 percent in gross revenue from corn and wheat, and about one-half percent from soybeans. For a representative commercial farm producing 400 acres of corn and soybeans each year, these user fees would cause an annual gross loss of revenue of about $900.

By removing much of the favored treatment of water transportation, higher fees for inland waterway users would encourage a more economic pattern of investment in these facilities and in competing modes. Both taxpayers and users would have a common interest in insuring that only economic projects are undertaken. Nevertheless, such a shift in policy could adversely affect some interests, such as grain farmers. A balance between the efficiency benefits and adjustment costs might be struck by phasing in the increased waterway fees' as is proposed in the Domenici amendment.

DEEP-DRAFT NAVIGATION

Under current policy, the Coast Guard and the Army Corps of Engineers will spend about $4.8 billion between 1983 and 1987 to build, operate, and maintain deep-draft navigation facilities. Under an administration proposal (S. 897), ports would return about $2.1 billion for Government operation and maintenance costs. In addition, in its fiscal year 1983 budget, the administration proposed user fees to collect $1.4 billion over this period for Coast Guard operating costs related to deep-draft navigation. Together with the proposed deep-draft port fees, these would virtually cancel out the substantial subsidies now received by coastwise, foreign-flag, and Great Lakes shipping.

The impact of user fees to recover operating and maintenance costs for ports would probably be small. Total transportation costs of most exports and imports would increase by less than 1 percent. Many smaller harbors with relatively high operation and maintenance costs, however, could experience increases well above these averages.

Fees also would be much higher in ports that plan major capital improvements, particularly dredging of deeper channels to prepare ports to handle large, high-efficient coal-carrying ships. As a result, such ships might be charged an additional $1 per ton of coal in some ports. But even this substantial fee is far less than the anticipated savings from using the larger ships. Thus, overall transportation costs would be lower and coal exports would be stimulated.

STRATEGIC PETROLEUM RESERVE AND FULL COST RECOVERY

As an insurance policy, the stratagic petroleum reserve (SPR) is perhaps the single most important element of our Nation's oil security. In the event of a major disruption in foreign supply, a fully stocked reserve could offset gross national product loss of about $150 billion and counter the attendant inflation and unemployment.

Though the SPR would benefit the economy at large, these benefits would be allocated in proportion to oil use. Heavy users would benefit more from the SPR than those who use less, but under current policy, taxpayers at large would finance the SPR. By contrast, financing the SPR with a charge on oil consumption would be appropriate.

The Congress placed this program off budget for 1982, and hence its costs are not counted as part of the unified deficit. Nevertheless, outlays for the SPR, projected to total $13.6 billion between 1983 and 1987, represent a real expenditure, the impact of which is exactly the same as if it were on budget. A tax of 50 cents per barrel—perhaps in the form of an import fee on crude oil and refined products or a refiners' fee with equivalent tax on imported products—would increase Federal revenues by as much as $2.9 billion in 1983 and $14.5 billion over the 1983–87 period. This would be felt by consumers in the form of increased prices for petroleum products. Gasoline, for example, would cost roughly a penny per gallon more at the pump if this tax were in effect.

CONCLUSIONS

User fees can have a far wider application to Federal expenditures than is generally recognized. I have treated four examples in some depth to illustrate how the concept would work and to suggest some of the Federal expenditures that appear best suited to user fees. Numerous others also warrant consideration. Besides irrigation, candidates for market pricing include uranium enrichment, credit subsidies, and Federal hydropower. Taken together, these could reduce net Federal expenditures by as much as $18 billion from 1983 through 1987 relative to current policy. Candidates for full cost recovery include highways, aviation, and radioactive waste disposal. Full cost recovery for these and other programs could provide about $47 billion more than under current policy between 1983 and 1987. Tables 2 and 3, which we have appended to this statement provide details of these and other potential user fees.

There is a strong economic case for charging those who benefit from Federal services the full cost of expenditure made on their behalf. This would be a small but important step reducing the Federal deficit. But more important, the proper application of user fees would help guide long-term investments toward a more efficient national infrastructure and provide appropriate levels of Federal service. Inevitably, there are short-term costs to be borne, and these are major considerations. Phasing in fee increases would mitigate some of these transition costs. But ultimately, fuller application of user fees would make a strong contribution to the long-term health of the economy.

Thank you, Mr. Chairman.

TABLE 2.—POTENTIAL USER FEES FOR COST-REIMBURSED PROGRAMS

[In billions of current dollars]

Programs and services covered	5-year total 1983–87		
	Outlays potentially recoverable	Receipts under current policy	Receipts under administration's proposals
Highways: Recovery of spending from the general fund and an end to highway tax exemptions for State and local governments, buses, and alcohol fuels	45.6	36.7	36.7
Strategic petroleum reserve: Department of Energy costs for the strategic petroleum reserve	13.6	0.0	0.0
Aviation: Recovery of Federal Aviation Administration capital and operating costs excluding 15 percent for military aviation. (Currently, general aviation users pay 5 percent of their allocated costs and commercial aviation 82 percent.)	13.5	9.5	[1] 17.2
Postal service: Recovery of Federal subsidies for Saturday mail delivery, remote area service, and preferred mail rates (for nonprofits, newspapers, etc.) and for future cost-of-living adjustments for postal pensions now paid by the Federal Government	5.5	0.0	0.6
Coast Guard: Search and rescue, aids to navigation, and other programs that aid recreational boating and commercial users including fishermen. Administration proposal would recover only operating costs	4.9	0.0	3.4
Inland waterway navigation: Corps of Engineers operating and capital costs for the inland waterway system. Administration plan would amortize capital costs over 50 years	3.1	0.2	2.0

TABLE 2.—POTENTIAL USER FEES FOR COST-REIMBURSED PROGRAMS—Continued

[In billions of current dollars]

Programs and services covered	5-year total 1983–87		
	Outlays potentially recoverable	Receipts under current policy	Receipts under administration's proposals
Deep-draft navigation: Corps of Engineers operating and capital costs for channels and harbors more than 14 feet deep. Administration plan would amortize capital costs over 50 years or let local ports finance themselves.	2.8	0.0	2.8
Radioactive waste disposal: Research, development, and eventual construction costs for storage of high-level radioactive waste from electric power generation.	2.6	0.0	2.6
Patent and trademark fees: Processing costs for patents and trademarks.	0.5	0.3	0.5
Miscellaraous: Includes recreation fees, Federal Energy Regulatory Commission, Commodity Futures Trading Commission, Securities and Exchange Commission, Federal Communication Commission licensing, and charts, and maps	2.1	0.7	1.3
Total	94.2	47.4	67.1

[1] The administration estimate includes cost recovery for new air traffic control equipment.

Source: Compiled by Congressional Budget Office.

TABLE 3.—POTENTIAL USER FEES FOR MARKET-ORIENTED PROGRAMS

[In billions of current dollars]

Programs and services covered	5-year total 1983–87	
	Potential receipts	Receipts under current policy
Credit subsidies: Market rate interest for all new direct Federal loans. About one-half this amount is in agricultural programs, including price supports, agricultural credit, and Farmers Home Administration loans. Net budget reductions could be substantially greater since some loans might not be made through the Federal Government at market rates.	[1] 9.7	[1] 0.0
Uranium enrichment: Uranium processing by Department of Energy for sale to domestic and foreign customers	12.1	10.2
Irrigation: Water sales by Bureau of Reclamation to farmers, municipalities, and commercial users. If all long-term contracts were renegotiated, receipts could reach $16 billion on a market basis	1.0	0.3
Hydropower: Power sold by Federal Power marketing administrations with a 10-percent return on capital—as allowed private power companies	13.4	7.4
Total	36.2	17.9

[1] Does not include interest already being paid on these loans.

Source: Compiled by Congressional Budget Office.

Chairman DOMENICI. Thank you, Dr. Rivlin.

Dr. Lave, senior fellow from Brookings.

STATEMENT OF LESTER B. LAVE, SENIOR FELLOW, BROOKINGS INSTITUTION

Dr. LAVE. Thank you, Mr. Chairman, for inviting me.

I want to, first of all, commend Dr. Rivlin on what I think is some excellent testimony, and just elaborate in a couple of areas.

USER FEES ARE IMPORTANT

I want to point out that, from economic theory, user fees are important for two principal reasons. The first is that they increase equity by making sure that those who benefit pay. This is important because we should not impose needless burdens on general taxpayers.

In particular, in my written testimony I suggest that as Congress and the public desire protection of health, safety, the environment, and economic activities it is important that we appreciate both the costs and benefits of these regulatory agencies. One way of doing so is to make sure that the expenses of those agencies are paid for by the people who benefit, and I will elaborate on that in a moment.

A second general principle is that where the Federal Government produces goods and resources or sells assets, those services ought to go out at market prices. It is unacceptable that the Government should be undercutting private competitors by selling its goods and services at subsidized rates when there are competitive, private enterprises out there trying to survive.

A third principle is that when Government dispenses its goods and services or sells its assets, this ought to be done at market-clearing prices. Although the sale of mineral rights, in general, is an area that has worked very well in the last several years, there are still examples here of mineral rights that are essentially given away even though they are immensely valuable. In an era of budget stringency, it seems to me that that is simply unacceptable.

CONCERN FOR ENVIRONMENTAL QUALITY

An area in which I have been concerned a great deal in my personal research is environmental quality. Economists have been suggesting for some time that there is much that we can do to improve the operation of our clean air and clean water acts by using effluent fees or marketable discharge licenses rather than the current legal command and control system.

If we were to establish user charges in this area, an immense amount more money could be raised, and virtually every economist would testify that the overall effect would be one where these rules would be less burdensome to the economy and would be implemented much more efficiently.

The other special case of trying to make sure that we have market-clearing prices concerns congestable facilities—for example, on airports and highways. Much of the delay that we experience at our major airports is due to improper pricing. We have no system for allocating those scarce landing and takeoff slots during congested periods. As a result of that, billions of dollars of resources and time are wasted. From an economic viewpoint, there simply is no justification for continuing that kind of inefficiency.

We could increase safety; we could increase the efficiency of operations of airlines. We could do a much better service all around if we were to impose some congestion fees for peak times at peak airports. I have some estimates which I will get to in a moment which indicate that we could be talking about perhaps $1 billion a year being collected in these fees, and several times that being saved. The same is true for highways.

MAGNITUDES OF USER FEES

I would like to turn to my table for a moment to give some indication of the magnitudes of the user fees that we are talking about.[1] I have divided these into four general categories. The first is recovery of the costs of regulation; these come principally from the administration's proposal.

In addition, I have tried to look at some other agencies, such as the Federal Communications Commission, and the Interstate Commerce Commission. And it seems to me that in addition to the sorts of proposed increases by the administration, one could get somewhere between an additional $1 billion and $5 billion per year.

The second category is the pricing of goods and services at market prices or cost recovery. Here, it seems to me that there is somewhat more than can be done than above, particularly in the water area. There are some areas where I simply do not have enough data to be able to calculate, such as the sale of some of these mineral rights that are currently being given way.

In terms of congestion tolls, my rough estimate is that we could get on the order of $1 billion a year of congestion tolls from highways and perhaps $500 million a year from airports. I want to emphasize that the point of user fees is not the additional revenues which might accrue to the federal or other Governments, but the increase in efficiency and increase in safety that would come about if we were to make better use of these facilities.

The last area provides by far the largest possible contribution; it is the area of effluent fees for air, water and wastes of toxic substances. These numbers are fairly rough estimates, but I think there are good reasons to believe we could easily raise amounts of this magnitude.

My calculation, which is again a rough one, is that in addition to the administration proposal, we could get a total of somewhere between $43 billion and $100 billion per year in additional user fees.

USER FEES DESIRABLE FOR TWO REASONS

Again, the point I want to make is that these user fees are desirable for two reasons. First of all, they provide feedback effects on governmental decisions. How do we know whether a particular waterway that was built was really worthwhile?

We know that there are a number of waterways that were built were costly and were not worthwhile. In order to make sure that we have feedback so that we make fewer mistakes in the future and know when to pull back from our mistakes, we need to have some measure of how well we have done. User fees would provide such a measure.

The second general notion is one of trying to focus the Nation's scarce resources; we do not have enough that we can afford to throw them away. It seems to me that we need to have some way of getting out of particular areas where moneys have not been spent very productively in the past, so that we can free those resources and get the most growth out of the economy that we can.

Thank you, Mr. Chairman.

Chairman DOMENICI. Thank you very much.

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[1] See p. 26.

PREPARED STATEMENT OF LESTER B. LAVE, SENIOR FELLOW, BROOKINGS INSTITUTION

In violation of both equity and efficiency principles, the federal government uses general tax revenue to subsidize or pay totally for services and to acquire assets that are then given free or at a small proportion of their value to rich individuals. These subsidies were never a good idea, but are a particularly bad idea in a time of budget stringency when the government finds it difficult to secure funds to pay for necessary operations of government, including defense and Social Security.

The first general principle for enhancing both equity and efficiency requires that individuals who request a service pay the cost of providing service unless there is an explicit policy to transfer income to this group of users or promote some other social purpose. Since the latter is subject to vast abuse, it is prudent to ask that the social purpose be stated explicitly and that the price of attempting to achieve that purpose be specified. For example, food stamps or Medicare are programs whose specific purpose is transferring specific goods and services to a deserving group. Obviously, it would be foolish to expect user fees to recover the cost of these programs. The subsidy to general aviation was justified on the basis of promoting this activity, but has long since gotten to the point where it can pay its own way.

The first principle is particularly relevant for individuals receiving services from regulatory agencies. Those receiving licenses from the FCC should be expected to pay for the costs of the licenses. The same principle applies to all regulatory agencies, since society has determined these agencies are necessary for the smooth operation of these markets. For an agency like OSHA, firms ought to pay for inspection costs, especially if firms with good safety records are exempted from inspections. Similarly, Coast Guard inspections and even rescue activities ought to be billed to those requesting them, insofar as these people have the financial capacity to pay.

A second general principle is that, where a government service or product is sold in competition with private goods and services, it should not be priced under its private competitors. For example, TVA's electricity ought to priced at market, as should camp grounds. Needless to say, the additional revenues would be welcome additions to general revenues.

A third principle is that price ought to be the mechanism for rationing goods and services among those desiring them, except where it is explicitly desired to change the distribution of income. Thus, where there is a fixed quantity, an auction or other market clearing mechanism should be used. Thus, federal property, such as mineral rights, ought to be auctioned with the government attempting to get the highest price for its assets. While offshore oil leases are sold this way, many onshore leases are still given at drawings. This absurd procedure conveys extremely valuable assets to a lucky person, who then sells the lease at market price. What is the possible justification for giving a valuable asset away at a fraction of its value?

Two special cases of this principle are important. The first concerns private use of natural resources. It is clear that government ought to charge fees equivalent to private owners for timber, oil, coal, and other resources. By the same logic, government ought to charge for such natural resources as potable water and the assimilative capacity of the environment for the dumping of toxic materials. Effluent fees have been proposed for air and water pollution; they are also relevant for solid and other wastes dumped on land. These fees would serve not only to raise significant amounts of revenues, they would improve the quality of the environment and the rationality of environmental programs.

The second special case concerns congestion. Whether this congestion occurs at airports, highways, national parks, or ports, the failure to control it results in the waste of billions of dollars of society's resources. When cars are jammed on a highway so tightly that time and fuel are wasted, society would be better off if some of the cars were removed. Many of these facilities are subject to absolutely diminishing returns where the attempt of a few more people to use the facility results in total throughput falling. In economic jargon, the addition of users to a congestable facility results in an externality. A congestion fee or its equivalent is required to account for the externality and optimize resource allocation. These congestion tolls have been estimated for inland waterways, highways, and airports. The potential revenue from such tools would be billions of dollars each year.

The attached table displays the various categories of user charges, examples of each, and some crude estimates of the amount of revenue that could be realized. The sums are substantial and could make a major contribution to reducing the current deficit. More important, imposing these charges would (1) increase equity by having those who benefit pay, stop undercutting private suppliers, and stop giving away government assets; (2) increase efficiency by using market clearing prices rather than inefficient allocation mechanisms and provide better information on the cost of each service; (3) rationalize government programs by isolating those whose cost is very high relative to the amount that could be raised from user fees and provide vast incentives for regulatory reform to eliminate programs that serve little social purpose and impose large costs. These user fees are worthy of much more consideration than they have received in the past.

Economic and Legal Background

In this section, I will elaborate some of the economic issues and state the current legal framework for user fees.

The general source of government funds is tax revenues, primarily from the income and corporate profits taxes. One could conceive of an arrangement where these two taxes paid for all government owned assets and produced goods and services going to citizens so that the price were zero. There would be a vast demand for the mineral rights to government lands; the Government Printing Office (GPO) would get more orders, and government agencies generally would be swamped with requests. Some means would have to be found for rationing demand. Two mechanisms might be "first come first served" or a lottery. Unfortunately neither would provide feedback as to how much of a service to produce (for example, how many copies of a book to print), nor ensure that the good or service went to the individual with the greatest demand. If the GPO were giving its books away, they would presumably "sell out" of each, if for no other reason, then for fireplace fuel. They could decide how many to print on the basis of how "meritorious" each was judged to be. However, one person would be getting books to burn in his fireplace which another wanted to read. Mineral rights would go to the lucky, who could then sell them to the highest bidder. How would the government decide which assets to put on the market? Setting prices at zero would be unsatisfactory.

If one is to guarantee that the assets and goods go to the person with the highest demand, they must be sold at a price that clears the market. If feedback on the number of goods and services to be produced is to be gotten, then price must reflect costs. After a long phase of giving land to homesteaders, the government now sells land and has auctions for some mineral rights. The GPO prices publications at about the cost of production and in general there is a charge for goods or services rendered to an individual.

Policy toward the pricing of government assets and services is embodied in several sources. Congress provided formal legislation; the executive branch has proposed rules for implementing this policy; the courts have reviewed the attempts of agencies to price their services.

In May 1966, President Johnson summarized the case for pricing:

> When the Federal Government provides special services for special groups, it is both good economics and good government to charge fees for these services — good economics, because user charges make possible an efficient allocation of resources among alternative programs; - good government, because user charges ensure equitable treatment of the general taxpayer.

Congress' declaration on this matter is contained in the 1952 Independent Offices Appropriation Act. Title V provides that:

> "--Government activities resulting in special benefits or privileges for individuals or organizations be financially self-sustaining to the maximum possible extent;
>
> "--Regulations prescribing fees be as nearly uniform as practicable, and "--Fees be fair and equitable, taking into consideration direct and indirect costs to the Government, value to the recipient, public policy or interest served, and other pertinent facts."

In addition, Bureau of Budget Circular No. A-25 (9-23-59) attempts to implement the legislation as follows:

> "Where a service (or privilege) provides special benefits to an identifiable recipient above and beyond those which accrue to the public at large, a charge should be imposed to recover the full cost to the Federal Government of rendering the service. For example, a special benefit will be considered to accrue and a charge should be imposed when a Government-rendered service:
>
> (a) Enables the beneficiary to obtain more immediate or substantial gains or values (which may or may not be measurable in monetary terms) than those which accrue to the general public (e.g., receiving a patent, crop insurance, or a license to carry on a specific business); or
>
> (b) Provides business stability or assures public confidence in the business activity of the beneficiary (e.g., certificates of necessity and convenience for airline routes, or safety inspections of craft);
>
> (c) Is performed at the request of the recipient and is above and beyond the service regularly received by other members of the same industry or groups, or of the general public (e.g., receiving a passport, visa, airman's certificate, or an inspection after regular duty hours)."

However, deciding who shall be charged and how much they shall be charged has proved difficult to define. The Federal Communications Commission established a fee schedule in 1964 setting nominal charges for filing; its revenues paid for approximately 25 percent of the FCC's annual appropriation. At the urging of the Congress and executive branch, the FCC raised these fees in 1970 in order to recoup their full cost of operation. In particular, cable tlevision operators faced for the first time both a filing fee and an annual fee of 30 cents per subscriber.

The cable operators challenged the fee schedule and the Supreme Court held in 1974 that the assessment per subscriber was a tax, rather than a fee, since it was not related to a special benefit conferred by the FCC. In this (NCTA v. U.S.) and a related case decided at the same time (FCC v. New England Power Co.), the Court was trying to distinguish between a tax, which only the Congress can levy, and a fee charged for a specific service, where the service is rendered to an identifiable party and confers upon that party some benefit beyond what the agency was created to give to the general public. The Court held:

> "...no charge should be made for services rendered when the identification of the ultimate beneficiary is obscure and the service can be primarily considered as benefitting broadly the general public."

These two cases are the only rulings by the Supreme Court on these issues.

The FCC adopted a revised fee schedule on January 15, 1975. The new schedule was challenged and the Court of Appeals held the fee schedule did not meet the Supreme Court's criteria; it ordered the FCC to recalculate the fee schedule according to the Supreme Court ruling and to clarify the basis for the fees. Having been burned twice, the FCC admitted defeat. They appointed a committee to look into refunding the excess fees collected, but still have not decided how to do so. They suspended the collection of all fees effective January 1, 1977.

In a May 6, 1977 report the General Accounting Office criticized the FCC for its inaction.

> GAO believes that sufficient guidance is contained in recent United States Court of Appeals decisions from which a proper fee schedule can be established. As a result, contrary to the Federal Communication Commission's position, GAO believes that the Commission can make a good faith effort to recalculate its fee schedules and refund only the excess portion of the $164 million in fees collected from 1970 through 1974.
>
> The Commission interpreted the court decisions to require that fees not only be based on costs but also on the 'value conferred' upon the people or organizations paying the fees. The Commission stated that, in any fee processing, it has not been able to determine the value that the Commission's actions have conferred upon these people.
>
> GAO does not believe that the Court of Appeals required the Commission to measure separately the 'value conferred' upon the people paying the fee. Instead, based upon interpretation of the court decisions, the Commission can establish a proper fee schedule based solely upon cost.

Thus, the whole area is in a state of confusion. Congress declared its intent to have individual beneficiaries reimburse the government for the services they received. But Congress has not been willing to provide guidance, even though the FCC is paralyzed. One can feel some sympathy for the FCC which thought it was heading the wishes of Congress and the executive branch and found itself slapped down twice and given rules that it could not implement. Surely, it is up to the Congress to clarify what it desires.

There are two difficulties with the current statute. The first is the ambiguity associated with whether the fee must reflect the benefit conferred on the recipient. If so, there would appear to be no way of implementing a fee schedule, since it is nearly impossible to estimate the benefit to each recipient. If it were possible, the ratio of prices could be set equal to the ratios of marginal benefits and the absolute level set to recover average cost. But such refinements must await practical methods of estimating benefits to each recipient.

The second ambiguity is the estimate of the magnitude of costs to be recovered: What is "full cost?" For example, the National Library of Medicine might be required to recover any of the following categories of costs for using the automated bibliographic system MEDLINE: (1) the additional cost associated with nongovernment users (a very small cost), given that the NLM has set up the hardware and software, including the data base, and provided personnel to serve its own needs and those of other federal agencies (2) the above plus the cost of the additional hardware, software, and personnel required to run a large scale service versus what would be required for internal NLM use and that of certain other government agencies, (3) set the price for services so that the total revenue (imputed from internal use plus actual revenue received) covered the full costs of hardware, operating personnel, and associated factors, and (4) set the price to recover the full cost of the operation including the collecting and punching of the data base, the cost of developing the operating systems, and imputed overhead. Different parts of the act and court decisions might be interpreted to justify any of these concepts as reflecting "full cost."

Current pricing strategies are totally inconsistent across agencies. The Tennessee Valley Authority prices its services to recover their full cost, although that cost does not include taxes and other costs that a private firm would bear. Until recently, waterway users were specifically exempted by the Congress from paying any portion of the cost of constructing and maintaining inland waterways, including navigation aides. The Treasury Department charges a nominal amount for passports and the Department of Agriculture charges enough to cover the full cost of most inspection and grading services. Many agencies have attempted to implement the Bureau of the Budget directive, although it would be fair to say that pricing policies are far from uniform, either with respect to where a charge is levied or with respect to how much is charged. Where it is evident that an agency is performing services requested by individuals, there is no question about the need for a charge, except where prohibited by

Congress. However, where the agency is regulating an industry and the services are required by the regulation, such as by the FCC, CAB, and ICC, it is much more difficult to formulate defensible policy. Even where a charge is levied, the amount collected varies from more than the complete cost, as with oil leases by the Department of the Interior to nearly the complete cost, as with the Department of Agriculture, to less than full cost, as with NASA and COMSAT. There may be a pattern in the present policies toward whether to charge and how much to charge, but I have not found it. No pattern is likely to emerge until Congress gives more concrete guidance.

Selected References

General Accounting Office, Comptroller General of the United States, *Large Costs to the Government Not Recovered for Launch Services Provided bto the Communications Satellite Corporation*, October 8, 1971.

________________, *Establishing a Proper Fee Schedule Under the Independent Office Appropriation Act, 1952*, May 6, 1977.

Chairman **Domenici**. Next we will hear testimony from John Fowler, General Counsel for the Department of Transportation, and I understand you are joined by Charles Swinburn, Deputy Assistant Secretary for Policy and International Affairs. You are both welcome. Who will make the statement?

Mr. **Fowler**. I will make the statement.

Chairman **Domenici**. All right. Please proceed.

STATEMENT OF JOHN FOWLER, GENERAL COUNSEL, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY CHARLES SWINBURN, DEPUTY ASSISTANT SECRETARY FOR POLICY AND INTERNATIONAL AFFAIRS, DEPARTMENT OF TRANSPORTATION

Mr. **Fowler**. Mr. Chairman, members of this committee, it is a pleasure for us to be here today to present the administration's view on transportation user fees. As you know, Secretary Lewis was eager to appear before this committee, but recent scheduling problems have made that impossible. He has asked me to appear in his stead today in order that we might present timely views to you.

With your permission, I would like to have my formal statement placed in the record and deliver an abbreviated version this morning.

Chairman **Domenici**. It will be made part of the record. You may proceed.[1]

GOALS FOR USER FINANCING

Mr. **Fowler**. Let me begin by stating our goals for user financing of Federal transportation expenditures. They are: equity, efficiency, fiscal prudence and stability.

The basic point in equity is that the cost of systems, as has been stated here this morning, which benefit a limited group of citizens should be paid for by the people that use them, not by the general taxpayer. We should not use the Federal taxing mechanism to provide benefits for some citizens at the expense of others unless we have clear, explicit and overriding social or other objectives that cannot be met in some better way.

We believe that the urban mass transit program has such objectives and, to a degree, so does Amtrak. Otherwise, the major costs of freight transportation, highway transportation and civil aviation should be covered by users directly through the marketplace or through user payments to the Government.

The marketplace, we believe, is the best decisionmaker for making choices about which transportation services will be used for which purposes and at what price, and how much should be invested in new facilities. It works properly, however, only if firms take account of all relevant costs, including their rates for transportation. If they do not have to account for costs, including the costs of Government-provided services and facilities, the prices they quote understate the costs of the services they are offering.

When this happens, good decisions balancing the utility of various services against their costs cannot be made because the marketplace is getting false signals on costs. Too much of some services will be used, too little of others, and although the cost to some users may go down, society's total cost for transportation will go up because the most efficient possible combination of services is not being used.

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[1] See p. 30.

The parallel effect of this distortion is that investment decisions are made with too little regard for cost. When users do not have to pay for facilities and services, they will always press for more and better ones; that is simply human nature.

When users must act as investors, however, and have to pay the cost of the improvement, the pressures they apply on Government will be tempered by the amount of the cost of the project. The result will be an improvement in Government decisionmaking and allocation of investment dollars.

Fiscal prudence is the third goal that we have listed at the outset of this statement. User charges help us move toward this goal. Less pressure on the Government to spend due to the accountability of user fees means the Government will spend less.

Further, with full cost recovery, increases in Government spending on a transportation system are always offset by increases in Government revenue. Thus, the fiscal effects of these spending increases are as neutral as is possible.

Similarly, reductions in Government spending trigger questions concerning stability. One thing that beneficiaries of Government transportation spending are unanimous in demanding is stability and predictability over time in the Government spending levels. We hear this constantly from State and local government and from private sector users. They want to make their plans at least a few years ahead, and cannot do this effectively if the Government continues changing things.

We share the user group's view about stability in funding, but we think it is only through user charges that this type of stability can be obtained. Few programs are truly sacred, and the priorities set by political mechanisms are constantly changing.

USER CHARGES PROVIDE STABILITY

Nonetheless, basic transportation requirements go on, shaped by changing technology and changing market conditions, and user charges do provide an effective way of maintaining long-term stability because a separately identifiable revenue stream is available.

Nothing illustrates the merit of this point better than the history of the Federal aid highway system and its contribution toward highway construction. Over decades, through many administrations and even more Congresses, the steady flow of highway user revenues has kept this vital program going in a stable fashion.

Mr. Chairman, when Secretary Lewis testified before the Public Works Committee on waterway user charges, you made a telling point when you said that user charges constitute a good Government issue with no really strong constituency. We cannot agree with you more.

We believe, however, that our point about stability gives us a base from which we can appeal to the long-term self-interest of the user groups. No group can count on always being the victor in the political struggle for Federal funds, and given our current economic condition and the need for fiscal frugality, users willing to pay for the services and improvements they want and need rather than scrambling for a share of the general taxpayers' dollar can be confident that their needs will be met.

This administration has made that point very explicit in its treatment of inland waterway expenditures in the fiscal 1983 budget request. The Corps of Engineers budget for this purpose has been reduced by nearly 25 percent, with a statement that funding will be restored if full cost recovery from commercial users of the inland waterways is enacted by Congress.

REDUCED FUNDING EXPECTED WHEN PAYMENTS DO NOT COVER COSTS

In general, we will be applying this principle to all programs where we expect user financing. When user payments do not cover program costs, users must expect that the Administration will seek reduced funding for such programs.

We do not believe there is a better way to underline both the seriousness of our intent and its coincidence with the long-term interests of a user.

Another point that we can and must emphasize to user groups is that we are being consistent across the modes.

Chairman **Domenici**. Are you giving up already, Senator Boschwitz? [Laughter.]

Excuse me for interrupting. I just wanted to make the point that he is leaving. [Laughter.]

Senator **Boschwitz**. Mr. Chairman, why do we not just enter this statement in the record, since it is quite repetitious. I notice that they give you a good deal of credit for the measure you have introduced with respect to user fees.

Chairman **Domenici**. That has all been done. He does not say that in his statement.

Senator **Boschwitz**. He did that already. You have not been listening. [Laughter.]

Chairman **Domenici**. I tell you, repetition has some significance around here. Sometimes people have to hear the same thing many times.

How much longer did you have?

Mr. **Fowler**. Not very much, but I am perfectly happy to conclude at this point and accept questions.

Chairman **Domenici**. Why not wrap it up in your own way?

Mr. **Fowler**. As you know, we do have user fee proposals in the transportation area in highways, aviation, and waterways. The waterway user fee proposals include inland, Coast Guard and port charges. In short, we believe that we are being both consistent and aggressive in implementing the principles that we have discussed and that have been discussed by the other witnesses.

We realize, as you do, that we have not chosen an easy path 'but we are convinced that it is the correct path, and we would like to assure you that our commitment to achieving the goals is genuine and strong.

We would be glad to answer any questions.

Chairman **Domenici**. Thank you very much.

PREPARED STATEMENT OF JOHN FOWLER, GENERAL COUNSEL, DEPARTMENT OF TRANSPORTATION

Mr. Chairman, members of the Committee, it is a real pleasure for me to be here today to discuss user charges. In your request for our appearance, you asked us to focus on a number of areas. I will speak to your points, but first I would like to discuss the role of user charges in transportation policy. Let me begin by stating my goals for the financing of Federal transportation expenditures. These are:

--- Equity;
--- Efficiency;
--- Fiscal prudence; and
--- Stability.

The basic point about equity is that the cost of systems, services or facilities which benefit a limited group of citizens should be paid for by the people that use them, not by the general taxpayer. We should not use the Federal taxing mechanism to provide benefits for some citizens at the expense of others unless we have clear, explicit and overriding social or economic objectives that cannot be met in some better way. I believe that the urban mass transit program has such objectives, and, to a very limited extent, Amtrak. Otherwise, the major costs of all freight transportation, all highway transportation and all civil aviation should be met by the users, either directly through the marketplace or through user payments to the government.

User charges promote economic efficiency in transportation in two ways. One way is through their effect on the use of transportation facilities and services. The other, closely related, way is through the effect of user fees on investment and spending decisions.

Let me explain how these two effects work. The key factor is the impact of user fees on the prices or rates charged by firms that use government-provided facilities to carry on commercial operations. This includes both deep-draft and shallow-draft commercial navigation, trucking and commercial aviation. In each of these cases, private firms use government facilities or services to help them provide carriage in the private market, at a price and with the objective of making a profit.

The marketplace is the best decision-maker we have for making choices about which transportation services will be used for what purposes, at what price, and how much should be invested in new facilities. It can only work properly, however, if firms must take account of all relevant costs when they set rates for transportation. If they do not have to take account of their costs, including the costs of government-provided services and facilities, the prices they quote must understate the costs of the services they are offering. When this happens, good decisions, balancing the utility of various services against their costs, cannot be made, because the marketplace is getting false signals on costs. Too much of some services will be used, too little of others. The net result is that, although the costs to some users go down, society's total costs for transportation go up, because the most efficient possible combination of services is not being used.

The parallel effect of this distortion is that investment decisions are made with too little regard for costs. When users do not have to pay for facilities and services, they are always going to press for more and better ones. This is simply human nature. Further, no amount of government analysis of costs and benefits of projects can be an adequate substitute for the price mechanism. When users have to pay the costs of improvements, the pressures they apply on government will be tempered by the amount of these costs. The result will be an improvement in government decision-making.

Fiscal prudence is the third goal that I listed at the outset of this statement. User charges help us move toward this goal in two ways. One stems directly from the improvement in the government's decision-making that I was just discussing. Less pressure on the government to spend means the government will spend less. It is just as simple as that. The other point is that, with full cost recovery, increases in government spending on a transportation system are always offset by increases in government revenues. Thus, the fiscal effects of these spending increases are as neutral as is possible. The same point holds for reductions in government spending.

One thing that beneficiaries of government transportation spending are unanimous in demanding is stability and predictability over time in the government's funding levels. We hear this constantly from State and local governments and from private sector users. They want to make their own plans at least a few years ahead, and they cannot do this effectively if the government keeps changing things.

I share the user groups' view about stability in funding, but I think that it is only through user charges that this kind of stability can be obtained. Few programs are truly sacred, and the priorities set by the political mechanism are constantly changing. Nonetheless, basic transportation requirements go on, shaped by changing technology and changing market conditions. User charges do provide an effective way of maintaining long-term stability, because a separately identifiable revenue stream is available. Nothing illustrates the merit of this point better than the history of Federal aid to highway construction. Over decades, through many Administrations and more Congresses, the steady flow of highway user charge revenues has kept this vital program going in a stable fashion.

Mr. Chairman, when Secretary Lewis was testifying before the Public Works Committee on waterway user charges, you made a very telling point when you said that user charges constitute a good-government issue with no really strong constituency. I could not agree with you more. I do believe, however, that this point about stability gives us a base from which we can appeal to the long-term self interest of the user groups. The point that we can make with some force is that those who rely on present political strength to ensure future government spending may find that they are leaning on a very weak reed. No group can count on always being the victor in the political struggle for Federal funds. Further, given our current economic conditions and the need for fiscal frugality that is likely to last for some time, these battles are going to be much sharper than they were in the past and there are going to be far fewer winners. If users are willing to pay for the services and improvements they want, rather than scramble for a share of the general taxpayer's dollar, they can be confident that their real needs will be met.

I would like to note that the Administration has made this point very explicit in the treatment of inland waterway expenditures in the FY 1983 budget. The Corps of Engineers' budget for this purpose has been reduced by nearly 25 percent, with the statement that funding will be restored, if full cost recovery from the commercial users of the inland waterways is enacted by Congress. In general, we will be applying this principle to all programs where we expect user financing. When user payments do not cover program costs, users must expect that the Administration will seek reduced spending for such programs. I cannot think of a better way to underline both the seriousness of our intent and its coincidence with the long-run interests of the users.

Many people will argue that a policy that ties program spending to user charge receipts requires a dedicated trust fund for each program in order to be effective. As things now stand, we do have trust funds for the highway, aviation and inland waterway programs. The Administration's approach to port financing is not really suitable for a trust fund. The proposal that the Department of the Army has put forward for the ports envisages that individual ports will pay the Federal government directly for the costs they incur. In a situation such as this, where the user is making a direct payment for specific services and facilities, a trust fund would serve no useful purpose. I also have problems with the idea of a trust fund for the Coast Guard. Its services are so multifaceted, and the users so diverse, that it would be difficult to put the Coast Guard on a trust fund basis. Moreover, trust funds are useful when there are long lead times between the commitment of funds and their expenditure as in the case of highway construction. In the case of the Coast Guard, user fees would be financing current operations and maintenance outlays that are essentially coincident in time with fee collection.

Another point that we can, and must, emphasize to the user groups is that we are being consistent across the modes. If we were not consistent, the user groups that are asked to pay the largest share of their costs could justly accuse us of discrimination. Further, the argument that we make for user charges on the grounds of efficiency would unravel if all the modes were not asked to pay their full costs. Fortunately, I have no problem in saying that we are being consistent across the modes, especially the freight modes. As I stated at the outset of this testimony, the only present exceptions to our policy of full cost recovery are urban mass transit and Amtrak.

Table 1. User Fees
(millions of dollars in fiscal 1984)

Program	Current Fee	Administration proposed increase	Possible further increase
Recovery of Costs of Regulation			
Patents and Copyrights	53	43	67
GNMA	5	4	?
CFTC	1	22	0
FMCS	0	1	24
VA	0	105	400
FERC	25	35	30
Other (ICC, FCC, etc.)	0	0	1000-5000
Total			1500-5500
Goods and Services at Market Prices or Cost Recovery			
NOAA	27	29	15
Coast Guard	0	800	?
Corps of Engineers	82	458	440
Aviation	1670	1350	600
TVA	1700	—	500
Mineral Rights	?	?	?
Recreation	41	68	900
Highways (8700 expenditures)	—	?	?
Water (1000 expenditures)	--	0	1000
Total			3450
Congestion Tolls[a]			
Highways	--	—	1000
Airports	--	—	500
Total			1500
Effluent Fees[a]			
Air			20000-30000
Water			10000-30000
Solid and Liquid Wastes	0	501	2000-7000
Total			32000-87000
GRAND TOTAL			42900-101900

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[a] May accrue principally to state and local government. The 1980 CEQ Annual Report lists 1988 expenditures on pollution abatement as: Air-$37.6, water-$24.4, waste and other-$7 in billions of dollars. These estimates provide one way of estimating the magnitude of receipts from effluent fees.

When user fees are increased, or imposed for the first time, it is natural to be concerned about the potential impacts on profitability and employment in the industries affected. As you know, Congress required the Departments of Transportation and Commerce to carry out a thorough analysis of the impacts of user charges on the inland waterways, and we have recently reported to the Congress on this matter. We did find that the implementation of full cost recovery user charges would have short-term negative impacts on the barge industry, in terms of both employment and profitability. We also found that these effects would disappear over time as the underlying growth rate in barge traffic returned the industry to its pre-user charge traffic levels and allowed growth to resume from that point onward. Our analysis showed there would be definite effects on the earnings of some grain shippers as the cost of shipping grain increases from two to five cents a bushel depending on the location of the shipper. The increased cost of shipping some grain would have no discernible employment impacts.

We have also considered impacts of user charges in other areas. Port user fees would have no effect on total employment in shipping and foreign trade. We do not expect increases in aviation user charges to have any noticeable effect on the aviation industries. Commercial aviation has been paying the preponderant portion of its costs for some time.

In developing user fee proposals, the Administration has been careful to avoid charging users for services or facilities that should be charged to others or to the general public. For example, about 15 percent of the cost of the aviation system is attributable to military and government use and some weather observation activities, and we are not seeking to recover these costs from civil aviation. The Department of the Army has developed a cost allocation which identifies and sets aside the costs attributable to flood control, hydro power generation and other non-navigation purposes. About 50 percent of the costs of all projects authorized for navigation are allocated to commercial navigation under this approach. We believe that we have been very careful in conservative in ensuring that users will not be asked to pay more than their fair share.

Before closing this testimony, let me briefly review our current policies and proposals across all the modes. The proposals for transportation user fees will produce additional revenues in FY 1983 of slightly over $1.8 billion. These revenues constitute nearly three-fourths of the Administration's proposed user fees, and are the cornerstone for achieving greater equity and economic efficiency in government services.

Highways: One hundred percent recovery from highway users has been Federal policy for a long time, and we are continuing that policy. As you are aware, there is some question as to whether large diesel truck-trailers are being cross-subsidized by other highway users, such as lighter trucks. We have been studying this issue under Congressional mandate, and we will soon report our findings to the Congress.

Aviation: Commercial aviation has long been on a substantial cost recovery basis, and we want to make this full recovery of the costs attributable to this activity. We are proposing increases in user charges for both commercial aviation and for general aviation. We propose to return the passenger ticket tax to the eight percent which was in effect throughout the 1970's, and to increase gradually the fuel tax on general aviation over the next several years so that private and corporate users of the system would be paying a greater portion of their allocable cost. Enactment of these user charges will yield about an additional $1.2 billion in revenues in FY 1983, and will permit us to support higher funding levels needed upgrade and modernize the National Airspace System and to reauthorize the airport grants program at $450 million.

Waterways: The Administration is pressing forward vigorously with a comprehensive set of proposals designed to bring full recovery of the costs of the inland waterways, deep draft ports and channels and certain services of the Coast Guard provided for the maritime industry and the recreational boating community. Proposed fees for commercial users of the inland system and of the ports would provide an additional $448 million in FY 1983 to cover new construction and maintenance expenses. Inland waterway costs would be recovered through ton-mile fees; all traffic would pay a uniform fee to cover operations and maintenance and segment-specific ton-mile charges would be levied to recover the costs of future construction. We are asking that a non-Federal entity associated with each port recover the costs of both maintenance and improvement of that port's channels and reimburse the Federal government. We are proposing a wide range of fees for the Coast Guard's services varying from specific charges for ship inspection to annual fees for recreational vessels. Cost recovery in FY 1983 will be set at about $200 million, less than 100 percent recovery, in order to allow a period of adjustment. Cost recovery will go to 100 percent in later years.

Railroads: We are not proposing any user charges for railroads as the freight carriers are all in the private sector and do not use any Federal facilities. We are, however, proposing to eliminate a number of programs that subsidize some parts of the industry. This is essential, both for reasons of consistency and for the need to reduce the budget. We have sought, and Congress has enacted, legislation that will allow the sale or transfer of Conrail to the private sector in the next few years. We are terminating our program of credit assistance to railroads that was used, in part, to facilitate the restructuring and rationalization of the bankrupt carriers in the Midwest. The President's FY 1983 Budget ends Federal support for the Railroad Retirement Fund.

In short, I believe we are being both consistent and aggressive in implementing the principles that I have been discussing here. I realize, as do you, Mr. Chairman, that we have not chosen a politically easy path. I am convinced that we are right, however, and I want to assure you that my personal commitment to achieving these goals is genuine and strong, and I am looking forward to bringing about these much-needed changes. I will be glad to answer any questions that you might have.

Chairman DOMENICI. Senator Boschwitz, do you have any questions?

Senator BOSCHWITZ. I defer to you, Mr. Chairman, in the event that you, I am sure, will want to comment on this subject.

Chairman DOMENICI. I commented far in excess of what prudence dictates.

Senator BOSCHWITZ. Mrs. Rivlin, I wanted to ask, in your tables, how you arrived at the 3.9, 2.2, and 1.8 mills per ton-mile. Are the costs of the highways included in determining what the cost of trucking is per ton-mile?

Dr. RIVLIN. I can submit a detailed set of calculations for the record, but basically those subsidy estimates are the difference between what the Federal Government spends for these various modes and what they take in in user fees.

Now, there would be some argument about exactly what should be included and how costs should be allocated. For example, in highways, how much should be allocated to trucks and how much should be allocated to cars? One has to make such decisions.

[Material subsequently supplied for the record follows:]

DETAILS OF THE CONGRESSIONAL BUDGET OFFICE ESTIMATE OF TRANSPORTATION SUBSIDIES

Attached table 1 provides details on Federal spending for freight transportation in fiscal year 1980, as estimated by the Congressional Budget Office from the Appendix to the "Budget of the United States Government for fiscal year 1982" and from cost allocation estimates prepared by the Army Corps of Engineers, the U.S. Coast Guard, and the Federal Highway Administration. These estimates include direct federal outlays as well as indirect outlays in the form of reduced tax revenues (called tax expenditures), due to specific provisions in the tax code. This spending represents a snapshot in time, taken in 1980, and thus excludes previous federal spending, as well as planned future spending.

TABLE 1.—*Details on Federal aid for freight transportation for 1980 by mode and program*

[In millions of dollars]

Inland water:	
Corps of Engineers:	
Construction of locks and dams	$387.1
Rehabilitation of locks and dams	43.2
Operation and maintenance:	
Mississippi River flood control [1]	61.6
Locks and dams	146.9
Channels and harbors [2]	65.2
Multipurpose power [3]	20.2
Total Corps of Engineers	724.2
Coast Guard [4]	33.2
Total inland water	757.4
Railroads:	
USRA (mostly aid for Conrail):	
On-budget	672.1
Off-budget	35.9
ICC directed service	78.5
Federal Railroad Administration [5]	341.4
Railroad Retirement Board:	
Windfall payment	313.0
Regional rail	28.3

Tax expenditure for tax-free pension	320.0
Tax expenditure (rapid depreciation for boxcars)	40.0
Total	1,749.2
Intercity truck:	
Highway trust fund spending	9,212.0
General fund spending [6]	1,349.0
Total highway spending	10,562.0
Portion allocated to combination trucks [7]	3,074.0
Less combination truck portions of revenues for Highway Trust Fund programs [8]	2,192.0
Net spending for heavy trucks	882.0
Deep-Draft:	
Corps of Engineers:	
Channels and harbors:	
Construction	144.8
Operations and maintenance [9]	284.2
Total Corps of Engineers	429.0
Coast Guard [4]	276.1
Maritime Administration	694.8
Total	1,398.9

[1] Based on allocation by the Corps of Engineers of 25 percent of spending to inland navigation.

[2] Based on allocation by the Corps of Engineers of 17.5 percent of spending to inland navigation.

[3] Based on allocation by the Corps of Engineers of 11.25 percent of spending to inland navigation.

[4] Based on Coast Guard allocation of operating costs (letter from Captain Kime, U.S. Coast Guard dated December 23, 1981). These estimates include a pro rata share of Coast Guard spending for capital equipment and research and development.

[5] Includes FRA payments for redeemable preference shares ($106 million), local rail service assistance including $57 million in loan guarantee defaults, Alaska Railroad losses, rail safety program and the freight portion of research and development expenditures.

[6] Estimates derived from table FA-5 in Highway Statistics 1980, Federal Highway Administration, but excludes general revenue sharing and community development block grants spent on highways (an estimated $966 million).

[7] An estimated 29.1 percent of costs for 1977 based on preliminary results of DOT's "Highway Cost Allocation" study (working paper No. 12). This share could increase to about 39.5 percent in the mid-1980's, if the program shifts substantially toward resurfacing. Use of a pro rated estimate for 1980 would increase the share of costs for combination trucks by $411 million.

[8] Preliminary results from DOT's "Highway Cost Allocation" study indicate combination trucks paid 18.3 percent of user fees in 1977 and, with no tax changes, will pay 32.9 percent in 1985. An estimate of 23.9 percent is used here for 1980 to reflect continued growth in truck payments relative to smaller vehicles. This fraction is applied to outlays from the highway trust fund including payments made from user fees paid in previous years. If the estimate were based on 1980 cash flow into the trust fund, combination trucks would be credited with $372 million less in user fees.

[9] Based on allocation by the Corps of Engineers of 76.25 percent of spending to deep-draft shipping. It excludes an estimated 6.25 percent for channels and harbors less than 14 feet deep.

Subsides were calculated in two ways: by dividing spending by the estimated ton-miles carried by each mode in 1980 (adjusted to 1982 dollars using the GNP price deflator) and by taking federal spending as a fraction of federal plus private spending for each mode. Table 2 summarizes these calculations.

TABLE 2.—CALCULATION OF FEDERAL FREIGHT TRANSPORTATION SUBSIDIES

Mode	1980 Federal aid (in millions of 1980 dollars)	1980 domestic ton-miles (in billions) [1]	1980 private spending (in millions of 1980 dollars)	Federal aid in mills per ton-mile (1982 dollars) [2]	Federal aid as a percent of Federal aid plus private spending
Inland water	757	228	[3] 1,810	3.9	29.5
Railroads	1,749	932	[4] 26,350	2.2	6.2

TABLE 2.—CALCULATION OF FEDERAL FREIGHT TRANSPORTATION SUBSIDIES—Continued

Mode	1980 Federal aid (in millions of 1980 dollars)	1980 domestic ton-miles (in billions) [1]	1980 private spending (in millions of 1980 dollars)	Federal aid in mills per ton-mile (1982 dollars) [2]	Federal aid as percent of Federal aid plu private spendin
Intercity truck	882	560	[3] 90,384	1.8	1.

[1] Transportation Association of America, "Transportation Facts and Trends," December 1981, page 3. The domestic waterway ton-miles a assumed to have increased between 1979 and 1980 in proportion to total ton-miles including international traffic.

[2] Each 1982 dollar is estimated to equal 1.173 1980 dollars, using the GNP deflator.

[3] Transportation Association of America, "Transportation Facts and Trends," December 1981, page 2.

[4] Association of American Railroads, Yearbook of Railroad Facts, 1981, Edition, June 1981, page 10.

If these estimates were to be updated for 1983, several significant changes woul have to be made. First, based on the budget proposed by the President, federa spending would drop in almost every case—to $702 million in the case of inlan water (excluding $40 million from the current user fee) and to $1,014 million in th case of railroads, for example. The biggest change is the rail area, where no fund are requested for Conrail. On the other hand, federal aid through the Railroad Retirement Fund is scheduled to grow—to $350 million for the windfall payment an $375 million for the tax expenditure due to the tax free pension. Second, if inlan waterway user charges are increased as proposed by the Administration and i Coast Guard fees are imposed, the net federal subsidy to the inland waterway industry will be reduced by about $319 million to $383 million. Thus, if the Congress approves the President's proposed budget for 1983, the federal subsidy to the barge industry will be reduced by 49 percent compared with 1980 spending and the rail subsidy will be reduced by 42 percent.

A third adjustment should also be made for 1983. The 1981 tax act required railroads to change from so-called betterment accounting to depreciation accounting a used by all other industries. Once the transition is completed (in five years) railroads will probably be in somewhat worse financial condition than if they had been allowed to continue with betterment accounting. While their reported income will increase under depreciation accounting, so will their federal tax payments. During the transition period, however, the railroads will receive a signficant windfall in the form of a rapid depreciation of over $17 billion in assets. As a result, the railroad industry is likely to find their federal taxes reduced to almost nothing. In 1980, Class I railroads paid $310 million in federal taxes.

Senator **Boschwitz**. But the capital investment of the whole highway system and bridges, and so forth—all that is included?

Dr. **Rivlin**. That is right. Most of that is covered by the user fees in the form of gasoline taxes and other user fees paid into the trust fund.

Senator **Boschwitz**. In the case of the railroads, the granting of the rights-of-way to railroads has been included as part of the grant that you are giving to the railroads?

Dr. **Rivlin**. Well, we have not gone back into the whole history of the railroads. We are now talking about current subsidies.

Senator **Boschwitz**. In the case of irrigation where is most of that cost? You talked about that cost principally from the standpoint of California, I believe, in listening to your testimony.

Do you have a sense of where most of the $3.8 billion is spent?

Dr. **Rivlin**. We could give you a breakdown of that. It is not all California, but it is principally in the West.

Senator **Boschwitz**. On what basis do you say that in some places, farmers with access to federally subsidized water are growing two crops they would not otherwise raise at all: cotton and rice?

On what basis do you say that there is a glut on the marketplace because of that production? That is not always the case in either cotton or rice.

Dr. Rivlin. No, it is not always the case, but the principal point there is that rice, particularly, is a water-intensive crop. It is not something that you would grow in a very arid area unless you had subsidized water.

Senator Boschwitz. My colleague tells me it is hard to grow in the desert without water.

Dr. Rivlin. That is the point.

Senator Boschwitz. What would they grow instead?

Senator Gorton. Sagebrush. [Laughter.]

Senator Boschwitz. There would be a glut on the market of sagebrush.

Chairman Domenici. There already is a glut.

PART OF ADDITIONAL FEES TO BE BORNE BY FARMERS

Senator Boschwitz. I noted in your earlier testimony, Mrs. Rivlin, in February of this year you stated that you assumed—and you said that also today—that half the cost of the additional fees on river grain shipments would be borne by farmers.

Our experience is that all of the transportation costs have historically been borne by the farmers; that there is a discount depending on how far away you are from the marketplace.

On what basis do you make the assumption that half of the cost would be borne by farmers and the other half by grain elevators, consumers, truckers or waterway operators?

Dr. Rivlin. In general, you assume that the cost is passed on to the final consumer. This may not be true if markets are slack. Again, we could give you a more detailed discussion of the basis for the estimates for the record, if you would like. We were assuming that the increase in the price of grain would be about 6 cents a bushel. How much of that would be borne by the farmer and how much by the ultimate consumer would depend a lot on market conditions.

As a rough estimate of what the cost might be to the farmer, we were saying if they bear half of it; then this is how it would affect them.

Senator Boschwitz. Does the price of fertilizer and the price of other agricultural inputs also go up, and is it borne somehow by grain elevator operators and consumer and truckers at half the costs of the increases?

Dr. Rivlin. Well, if you were subsidizing fertilizer and you decided not to, you would have a similar kind of calculation. It would increase the cost of producing wheat, and the cost would be shared, depending on market conditions, between the farmer, the producer of fertilizer and the ultimate consumer.

MARKET CONDITIONS DETERMINE COST OF AGRICULTURAL COMMODITIES

Senator Boschwitz. Quite clearly, the cost of agricultural commodities has not been determined by inputs as much as it has been determined by market conditions. The cost of transportation has really not been part of the basis of those market conditions.

I think it probably is gratuitous to assume that, because historically farmers have borne the entire cost. If you go out to the country, there will be a discount on a bushel of corn or a bushel of wheat, depending on how far from Chicago and how far from the gulf ports it is.

I am not sure I could agree with your statement that assuming that half of this is borne by farmers and the other half by owners of grain elevators, consumers, truckers or waterway operators, then the farmers would absorb 3 cents of this increase.

How did you get the 6 cents per bushel?

Dr. RIVLIN. It is the same estimate, roughly, that the administration has in the section 205 study; it was verified by our agricultural experts who checked how the administration got the number and talked to some other people about it. We decided it was about right.

Senator BOSCHWITZ. I think in one of your earlier testimonies, you talked about the fact that it would cost 2 mills per ton-mile.

Dr. RIVLIN. That what would?

Senator BOSCHWITZ. The additional cost. We figure that it would be a good deal more than that; it would probably be much closer to 9 or 10 cents a bushel, at least from the upper Middle West which is removed from the marketplace. Historically, this, again, has been borne by the farmers.

It is 1,800 miles down to the gulf ports. Were you going to say something?

Dr. RIVLIN. Clearly, it does matter where you are, and the further you are away from the market, the more expensive the transportation cost is. The 6 cents is an average, and we would be happy to sit down with your calculations and think about more specific implications for particular areas.

Senator BOSCHWITZ. Quite clearly, it would be 9 or 10 cents per bushel up at our end of the Mississippi for the Upper Middle West, Iowa, Minnesota, the Dakotas, as they ship materials down the rivers.

All the indications we have from transportation costs, as they are now assumed or assessed, are that they are borne by the producer and that market prices are set at a central point, without regard to those transportation costs. So, we are going to have a good deal of trouble with these kinds of user fees, as far as I can tell.

You say in your testimony that ultimately most of the fees would be passed along to consumers. Again, we have not seen that happening. What the consumers want and do not want that is the ultimate measure of what the price will be in the marketplace. But the world marketplace in corn, wheat and soybeans has pretty much been established quite aside from the transportation costs.

USER FEES WOULD BE PENALTY TO FARMERS

It would be a very severe penalty indeed to farmers in my area, and in many others areas if we at this time impose those user fees. We are going to have to work with our distinguished chairman to see if we cannot find some middle ground or compromise, or perhaps develop a large number of user fees in other areas as well.

Certainly, philosophically, Mr. Chairman, I do not disagree with Mrs. Rivlin or the gentlemen who are here today. But the repetitive difficulty in the farm economy, makes it extremely difficult to support this kind of legislation.

We may have to expand the idea of user fees to all Government services in that case. Government services are given to individuals without any thought of return or user fees, and certainly the inland waterways as well as the highways and railroads are part of the national asset that have to be maintained.

IMPLEMENTATION TAKES TIME

Chairman **Domenici**. I understand. I do not think anyone who supports this approach philosophically would assume, Senator Boschwitz, that you could move from where we are to full implementation in a short period of time. I think we have had many of the various subsidies for a long time. I do not see how you would expect to get out from under them very rapidly.

I only have one observation, and then I would certainly yield to Senators Gorton and Symms. When you look at the inland waterway system, even if you want to ignore the operation and maintenance costs, and just run a physical inventory of what we have in place, it is obvious that we are going to have to start a second round of major renovation—taking down the very old locks and replacing them with new ones, and expanding them.

It is in that context that it appears to me that those with an interest in particular barge companies ought to be more prudent about this user fee approach. It seems clear that the next 10 to 15 years are not going to bring the kind of funding out of Congress that any President in the recent past, if that is any indication of the future, would sign that will replace, renovate and add to this waterway system based upon what is really going to be needed.

TYPE OF SYSTEM TO HAVE IS THE ISSUE

I think it becomes an issue of whether we are going to live with an outmoded, very inefficient system that is incapable of handling the traffic, or are we going to seek some recoupment that will permit us to take a look at the whole system and improve it.

I am reminded, for instance—I am not sure if any of you are aware of it; perhaps the Transportation Department is—of lock and dam 26. We waited around about 3 years after it was approved. It was held hostage by design by this Senator and some others until we got the 10-cent fuel tax.

I understand we already need the second phase of that lock. You know, we are going to be right back in the same position. We need to make a huge expenditure for the second lock. There are many people opposing it for reasons other than recoupment. Yet nobody has been willing to allow some graduated fee schedule.

We are going to need another couple hundred million dollars for the second lock, and how are we going to get it? That is only one of many things; as you look up the system, some of those are very, very old facilities that have to be replaced.

Senator **Boschwitz**. Mr. Chairman, with all due respect, some of the delays that were encountered with lock and dam 26, which, is below the confluence of the Illinois and Mississippi Rivers, heightened the cost. I have no idea how many years it will take to recover those costs.

Certainly, a second chamber should have been put in right away in lock and dam 26; it is kind of a bottleneck to the whole river. Hopefully, it will be done quickly and not delayed once again so that the costs of it escalate over a period of years.

Chairman DOMENICI. Senator Gorton?

Senator GORTON. Dr. Rivlin, one simply factual question.

Dr. RIVLIN. Certainly.

SUBSIDIZED IRRIGATION WATER

Senator GORTON. In your statement, dealing with irrigation, you said, "For example, subsidized irrigation water for cotton and rice in the West puts production of those crops at a competitive disadvantage in other regions." The West is growing more rice and cotton as a proportion of what we are producing in the United States than would be the case without those subsidies?

Dr. RIVLIN. That is right.

Senator GORTON. Now, would you go back to the chart about which Senator Boschwitz asked? I did not end up with an understanding of the nature of the subsidies either for rail or for truck.

Let us take rail; your line says railroad, 1980 actual, 2.2 mills per ton-mile. Now, what are the components of that 2.2 mills, and in what way or respect are we subsidizing railroads as a whole or does this spread across the country?

Dr. RIVLIN. This does spread across the country; it is everything we are spending for railroads, divided by the total. Regionally it is very uneven.

Senator GORTON. And that does not include Amtrak, I assume, because that does not have anything to do with freight?

Dr. RIVLIN. No; my estimate includes only freight.

Senator GORTON. Does it have anything in it other than Conrail?

Dr. RIVLIN. Yes. It has the Federal contribution to railroad retirement in it.

Senator GORTON. Is there anything other than those two components?

Dr. RIVLIN. It has some ICC component.

Senator GORTON. What would the figure be for, let us say, western and southern railroads, and for railroads outside of the Conrail area?

Dr. RIVLIN. Very small.

Senator GORTON. Conrail is the largest component of that 2.2?

Dr. RIVLIN. And the railroad retirement; that is spread over the whole.

SOURCE OF FEDERAL APPROPRIATION FOR HIGHWAY CONSTRUCTION

Senator GORTON. Now, let us go up to the first line. Is not the entire Federal appropriation for highway construction out of the trust fund, which is charged against highway users?

Dr. RIVLIN. There is some general revenue spending for highways, some of which is used by trucks. These are special kinds of things—Appalachian roads, and so forth—which are outside the trust fund.

Senator GORTON. The Appalachian Regional Commission, then, would be one element—the road part of it?

Dr. **Rivlin**. It would be one element.

Senator **Gorton**. Can you give me any other specifics in that respect?

Dr. **Rivlin**. Part of it depends upon one's allocation of the highway trust fund spending to trucks. Based on the most recent information, about which the Department of Transportation knows a lot more than I do——

Senator **Gorton**. So, some of this subsidy may be from automobile users rather than from general taxpayers, is that correct?

Dr. **Rivlin**. Right.

Senator **Gorton**. But it does not include anything which States offer? It does not include the fact, for example, that highway rights-of-way do not pay property taxes?

Dr. **Rivlin**. No, it does not include the State component.

Senator **Gorton**. So, the fact that railroads, privately owned, are paying property taxes and neither of the other forms of transportation have any comparable such burden is not included in this distribution of subsidies among these three categories?

Dr. **Rivlin**. No. We are looking at the Federal level component.

THREE DIFFERENT WAYS TO FIND USER FEES

Senator **Gorton**. Thank you very much. Now, I would like to go to the next point in this user fee area. As you know, and any of the other witnesses may comment on this if they wish, there are at least, it seems to me, three different ways of finding user fees in the inland waterway field.

The administration's proposal is essentially segmented; that is, the cost of both improvements and operations and maintenance of a given area would be based on the cost of maintaining or creating that specific area, as I understand it. That is the way the bill, so far reported out of Environment and Public Works, works.

Another general philosophy exemplified by Senator Hatfield would have a uniform national port fee that Congress would then distribute in the normal political fashion, without regard to efficiencies; that method while it can get the money necessary to provide these things, does not have the market efficiency that all of you mention.

The third way, of course, is Senator Domenici's bill that is already in effect—a 6- to 10-cent-per-gallon fuel charge utilized for these improvements. Now, that is different, it seems to me, from a segmented structure. You pay 6 cents a gallon whether you are in the most expensive waterway in the United States or one which requires practically no operations and maintenance at all. It still leaves to Congress rather than the market the determination of what you are going to use that money for, even if you raise that tax high enough to cover all of the waterways of the United States.

I am correct, am I not, in that analysis?

Dr. **Rivlin**. Yes, that is right.

Senator **Gorton**. Mr. Fowler.

Mr. **Fowler**. With regard to the proposals that we have, while the legislation is not yet up, the Secretary did state in testimony in mid-February that we are not considering a segment-specific charge for operations and maintenance; that we would have systemwide for operations and maintenance, and segment-specific for capital projects.

Senator **Gorton**. Systemwide in the form of some kind of fuel tax?

Mr. **Fowler**. On a ton-mile tax.

Senator **Gorton**. On a ton-mile tax, but not related to the value of the cargo, just simply ton-mile?

Mr. **Fowler**. Ton-mile; that is right.

DOMENICI METHOD APPLIES TO HIGHWAY CONSTRUCTION

Senator **Gorton**. Thank you for that correction. Now, it is the Domenici method which applies to highway construction; does it not? It does not matter how much the highway costs; the payment comes from so much per gallon of motor vehicle fuel?

Mr. **Fowler**. Yes.

Senator **Gorton**. Mr. Fowler, why is it satisfactory to build highways on the basis of a per-gallon fuel charge, but not satisfactory to build waterways by such a fee?

Mr. **Fowler**. Well, with regard to highways, we are creating a nationwide system across the ground, as it were, and the major Federal component in the highway system is construction. We have recently instituted a fourth "R" [reconstruction] in what used to be the 3R highway program.

Senator **Gorton**. I understand your description but as we are building new facilities in water transportation, why is the philosophy a different one, that each segment should be paid for individually?

Mr. **Swinburn**. I think the emphasis is with the capital construction costs on a segment basis on the waterways, Mr. Gorton. This is an attempt to pin down most specifically the proper user or the person who incurs those costs. That is not inconsistent with what we are presently living with or with what we will be proposing on the highway system.

Presently, there is a 4-cent per gallon highway fuel tax in place. There is also a series of other taxes, excise and use taxes, which, based upon studies done almost 20 years ago, related the wear and tear on the highway system to the users.

We will be reporting to you within a month a new evaluation of that, with new recommendations on how to restructure the highway proposals so that they will be oriented toward the specific users. The fuel tax is only a portion of that and it is a portion designed to recover from both trucks and automobiles their proper share of the cost of the highway.

Senator **Gorton**. But nevertheless a direct parallel would have at least a significant portion of capital improvements in the water field based on a fuel tax, no matter where it was undertaken, would it not?

Chairman **Domenici**. I did not hear the question, Senator. Could you repeat it?

Mr. **Fowler**. Only if you orient it toward what the expenditure is as opposed to who the user is. I mean, if you orient it toward the user, identifying the user, then I do not think it is a direct parallel because it is very difficult to identify a direct user on the highways.

Senator GORTON. I guess I have driven that subject as far as I can, and I have only one other——

Senator DOMENICI. Senator, would you yield for just an observation?

Senator GORTON. Certainly.

LEGISLATION AIMED AT EQUITABLE RECOUPMENT

Senator DOMENICI. I want you to know, Senator, and the record to reflect that the 6-cent fuel tax, which will soon become 10, that resulted from the efforts 3 years ago is not really my approach. I want you to know that the legislation that I introduced was not that way at all.

The legislation I sponsored allowed for a percentage recoupment, with the managers of the system levying charges that could vary from something like a ton-mile tax to fees at the locks. The legislation was aimed at some equitable recoupment measured as a percentage of what the Federal Government expected the entire cost to be.

The law did not come out the way I proposed because by the time we got through bargaining in both Houses, there was going to be no authorization for the lock. As a result, the House, which originates tax legislation, finally consented to the graduated schedule, up to 10 cents. I do not want anyone to think that the current fuel tax for the inland waterway system is my best thinking on how to impose a user fee. Rather, it is the result of how the legislation evolved in order to get anything at all.

I do not have a precise approach to be more equitable, but it does appear to me that if you raise the entire recoupment by a fuel tax, you are going to have some enormous distortions. I mean, there are parts of this waterway system that will close up; there is just no question about it.

We have one system that ships nothing but sand and gravel. There is no question that we would not build that system if we used the marketplace. You would still have one system to ship Rudy's grain, obviously, but you surely would not have the ones around that ship products like sand and gravel. They would go broke; I mean, they would just close up.

PORTS CLAIM PROPOSALS WILL CREATE CLOSEDOWNS

Senator GORTON. That does lead directly, Mr. Chairman—and I thank you for that correction—to the next question, and that is that a number of ports, including some in which I have a parochial interest on the Columbia River, and including one represented by Senator Symms here, and including many smaller ports in the southeastern part of the country, claim that the administration's proposals will create such a drastic distortion in the pattern of water-borne commerce, or for that matter in the pattern of commerce overall, that they will effectively close down some waterways and some ports.

I wonder if each of you will tell us whether or not your advocacy of this program, in the face of that criticism, is because you disbelieve that counsel, that is, you do not think that these fees would be so drastic as to very substantially reduce or eliminate commerce at given ports. Alternatively, is it, as far as you are concerned, that that is tough? We need the economic efficiency and the economic efficiency is more important than the survival of those particular ports?

Mr. **Fowler**. I believe the Secretary has also testified on this point that we do understand some of the competitive disadvantages that may be created from the proposal we have sent up, and we are willing to work with the committee and its staff to try and figure a way to apply our user fee concepts in a manner that would not unduly discriminate against any particular port and/or waterway.

Senator **Gorton**. So, clearly, the Department of Transportation does not take the view that that is tough, and if they close, they close?

Mr. **Fowler**. Absolutely not.

Senator **Gorton**. Dr. Rivlin, what is your view on that subject?

Dr. **Rivlin**. My view is the same. We have emphasized, I think, that many of the long-run economic advantages of going to full-cost recovery would have very difficult short-run consequences, and this is a good example. We have not gone into this port by port, but I have listened to the same witnesses, and there clearly are areas that would be severely affected; that creates some very difficult problems.

Senator **Gorton**. Mr. Lave, you are more likely, I suppose, to tell me that that is tough.

PUT FEES ON WATERWAY-BY-WATERWAY BASIS

Dr. **Lave**. "Tough" is the wrong way of putting it. I think that would be marvelous. If you take a look at the Corps of Engineer statistics on freight on each of the inland waterway systems, what you find is that there are two or three segments that carry virtually all of the traffic.

If you take a look at it by miles of inland waterway system or by amount of money being spent, then there is certainly no uniform relationship at all between money being spent and what is being carried.

I can understand why Congress might want to press some new waterways and some new expenditures on areas where those will not be used, but I do not understand why, from the benefit of the whole economy, one can begin to justify those at all.

I want to argue very strongly, and did in some work I did for the Department of Transportation almost a decade ago, that a proper way of doing this would be to have these fees be on a waterway-by-waterway basis and to try and get something reasonably close to full-cost recovery from each one of those.

I would certainly temper that and I would phase it in, but I think that if you had any program even close to that, then we would find that many of the current waterways would simply be shut down; that is, there would be no vast, expensive maintenance.

Senator **Gorton**. I have one more question, if I may, for Mr. Lave on a different subject. I am on your table 1,[1] Mr. Lave, and I am down on those tremendous last three figures, the effluent fees. They almost look like they could balance the budget for us.

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[1] See p. 26.

Chairman Domenici. Let us do it. [Laughter.]

Senator Gorton. I have a question or so about them. As an example, let us take the air effluent.

Chairman Domenici. What page are you on?

Senator Gorton. I am on table 1 of Mr. Lave's testimony, $20 billion to $50 billion in possible further increases.

I would appreciate your telling me the assumptions on which that $20 to $50 billion figure is based. Is that a charge per ton of SO_2 and every other chemical or waste which is released into the air? If it is, what is the basis of how much is charge per ton, and if it is, is it based on allowing the same amount of total discharges that we are engaged in in the United States?

Is it a total substitute, for example, for the Clean Air Act? Does it assume the success of the Clean Air Act or just where we are right now?

ABATING SULFUR DIOXIDE COSTS ABOUT $1,000 A TON

Dr. Lave. In 30 seconds or less, these calculations are quite conservative. One way of getting at them is that the cost of abating sulfur dioxide now runs about $1,000 a ton; that is, under the 1977 amendments to the Clean Air Act requiring scrubbing of all coal-fired powerplants, the marginal cost of getting rid of a ton of SO_2 is somewhere between $1,000 and $1,500 under that legislation.

Senator Gorton. A ton of what?

Dr. Lave. Sulfur dioxide?

Senator Gorton. Per year.

Dr. Lave. Every ton put out. If you take the number of tons of sulfur dioxide and an effluent fee of a thousand dollars a ton, that would raise between $25 and $30 billion itself.

Senator Gorton. With no controls? In other words, just wiping out controls entirely?

Dr. Lave. No. Given how much is currently being produced—that is, we would still be abating more than 50 percent of the sulfur dioxide. These effluent fees are conceived of as a substitute for the emission standards under the Clean Air Act for the criterion pollutants. I have not assumed them for the section 112 or hazardous pollutants. For current levels of the criterion pollutants, there is not a catastrophic risk to health on property. Instead, the issue is whether we want 80 percent abatement of the sulfur dioxide or 90 percent.

Senator Gorton. Or $20 billion.

Dr. Lave. Or $20 billion. By setting fees of this sort, we could allow every individual polluter to determine how much abatement he will undertake. That would result in much cleaner new facilities being built and lots of retrofitting that does not take place now. That would tend to get this matter out of the administrative agencies and out of the courts and into the marketplace.

Senator Gorton. Of course, under those circumstances, if your fee schedule were high enough, you would collect no money because it would be cheaper to put on even very, very expensive equipment. On the other hand, if your fee were low enough, companies would abandon the equipment they have now.

Dr. **Lave**. That is correct, sir. There are several premises on which one might estimate the fees. One of the ways would be to look at what the cost of abating pollution would be in about the range you want it, that is, getting rid of about 50 percent of sulfur dioxide results in a cost of about $1,000 a ton. So that would be an appropriate effluent fee. What you find, by and large, is that producers who could abate their SO_2 for less than $1,000 a ton, would go ahead. The people who would not would pay the effluent fee, and that would raise $25 to $30 billion itself.

Senator **Gorton**. Thank you, Mr. Chairman.

Chairman **Domenici**. That was a long question, a very long question.

Mr. Symms.

OPENING STATEMENT OF SENATOR SYMMS

Senator **Symms**. Thank you, Mr. Chairman.

I appreciate the line of questioning and I think Senator Gorton asked a lot of questions. I am certainly interested in seeing that the port he refers to is the Lewis and Clarkton Port which is on the Snake River. It is on the upper end of the Columbia system, and I would just say, to answer what Senator Boschwitz—the point he was trying to make, I think there is undisputable evidence that if we increase user fees, the farmers will end up paying it There is nobody else in the chain that can pay it. Because farmers sell into a free market, they always have to pay the transportation cost out of the price of the commodity. There is no other way it can be done. It will mean less revenue back to the farm.

IF NOT CAREFUL MORE WILL BE LEAVING FARM

So I do think, as we phase into this, and I think philosophically certainly the concept of user fees has a great deal of merit—but I think we have to recognize that under the present situation of increasing a farm debt and the debt equity ratio, that anything that would be too sudden in this respect will only make a more rapid change in what is going on in the farm economy. I know that during the fifties we had several hundred thousand people leave the farms, and I think if we are not careful, we will see this happen again.

But, I was interested in the one comment—Senator Gorton asked the question about different segmented rates, not only for inland fees but the cost of applying to seaports. Now, the administration provision is that you, on both inland water charge and deep draft port charges—they would not appreciably affect the competitive relationship. Do you agree with that? You partially answered this, but how can this not affect the competitive relationship between, say, Portland, Oreg., and, say, Seattle, Wash.? I would like to ask each one of you.

How can the administration's position not affect the competitive advantage or disadvantage between Portland and Seattle, or Portland is the port that requires dredging and Seattle does not?

NO PORT SHOULD PAY MORE THAN 125 PERCENT

Mr. **Swinburn**. I think it is important to point out that the statement regarding the administration's position was modified to say that no port should have to pay more than 125 percent of the average cost per ton of dredging charges. I believe that the conclusion comes from a series of analyses as to the impact it would have on commodities moving out of those ports.

I have staff here that have done the analyses, and we can supply them. But it has that cap.

Senator **Symms**. At what point?

Mr. **Swinburn**. 125 percent of the average charge in the system.

Senator **Symms**. How much do we consider in this comparison, say, specifically between Portland and Seattle? There are some other examples but it just happens to be one I am familiar with. How much do we consider if the defense capability or the necessity for spreading out some of the port facilities in the country, not having them all congregated at the natural ports?

Mr. **Swinburn**. In which calculation?

Senator **Symms**. If we impose some kind of port fee that would make it so that it is a competitive advantage to ship everything out of Seattle instead of Portland, over a period of years, so that 50 years from now Seattle has all the business and Portland has none of it, what is—is not there some disadvantage just from a security standpoint to have all your eggs in one basket? You can move around to other ports, Los Angeles compared to San Francisco.

Mr. **Swinburn**. I do not think any analysis we have done would lead one to the conclusion that that would be the effect. I have not asked what the defense implications are, under the hypothetical. I could ask and get back to you.

CONGESTION IS PROBLEM

Senator **Symms**. Let us talk also about the congestion.

If presently most of the wheat in the Northwest or a great deal of it goes out of Portland—how much of it goes out of Seattle? Very little.

So all of the transportation hauls all the wheat into Portland. If we pass something that disrupts that, then we have another problem. That is my point.

Chairman **Domenici**. Wheat is not going to Seattle, is that correct?

Senator **Gorton**. If you build me a nice canal, we can.

Senator **Symms**. We are trying to get the Tennessee-Tombigbee now.

Mr. **Fowler**. The question is the congestion problem. If there is congestion, there is a cost to congestion that is in the demurrage charge to shippers. When that charge gets to the point where it reaches the difference between the costs, then the traffic would not go to the port in which there was congestion. It would move to the other port.

Senator **Symms**. Well, Senator Gorton made a good point that some of the people at some of these ports say they have spent millions of dollars in private facilities as well as the Corps of Engineers having spent millions of dollars building the facilities, and if we segment the charge, people would use rail or truck to go further down the river where the cost is less and we have wasted an investment.

Mr. **Fowler**. That is why we propose to have the operation and maintenance on a systemwide basis.

Senator **Symms**. I have one other question, Mr. Chairman.

CONGESTION FEES ON HIGHWAYS

I wanted to ask Dr. Lave how do you apply congestion fees to the highways?

Dr. **Lave**. Modern technology would not require people to pull into a toll gate and pay a fee. There are a number of fairly elaborate systems around the world. For example, in Singapore there is a special ticket one buys to get into the downtown. There are a number of ways to do it that are not cumbersome. Some studies that have been done, including one that I did as well on the Capitol Beltway, show the magnitude of congestion. The externality imposed on other drivers by each car is on the order of 4 cents a mile. If we were to levy this magnitude of fee, we would get some people to drive at different times and get more people per car. The result would be a lower social cost in terms of wasted fuel and in terms of commuting time. Again, I emphasize the primary purpose is not so much to raise money as to get the economic efficiency.

Senator **Symms**. Spread out the use of the highway.

Dr. **Lave**. It is not to penalize but to stop the immense wastage of gasoline by people driving bumper to bumper.

May I make one point on your question with respect to inland waterways?

WATERWAY SYSTEM INEFFICIENT

In some earlier studies I did on the inland waterways for the Corps of Engineers, what I found was that these farmers were already paying the cost in the sense that they were waiting a long time to traverse each one of those locks. I found that the system was immensely inefficient in trying to deliver what everybody wanted. Of course Congress could appropriate enough money so that there would be sufficient capacity that no one would ever have to wait. The cost of that would be so immense that nobody has even talked about that.

Chairman **Domenici**. Some barge people have.

Dr. **Lave**. I stand corrected.

What we have to do is worry about how we can help farmers not just by giving them inferior subsidized transportation but by getting them better transportation that they have to pay more for. I would think there would be a fairly substantial offset if we could offer much better transportation services at a higher price. After all, they have some other alternatives open to them now, and many people from the Upper Midwest ship their grain by truck despite the immensely greater cost of doing so.

CHANGE COMPETITIVE RELATIONSHIP

Dr. **Rivlin**. Could I make a comment? It seems that Senator Symms is asking something extremely basic. But the problem is if it were true that user charges related to costs did not change competitive relationships, then we would not need them. The point really is to make it more expensive to use a higher cost mode or facility or port. The question is: Do you make it so expensive that you might close down a port? I think there is a real question about that in a few places. But it really is of the essence of this conflict that you do change the competitive relationship.

Senator **Symms**. Thank you, Mr. Chairman.

Chairman **Domenici**. I understand, for instance, on wheat shipped to Europe at Rotterdam, the institution that receives grain imports to the European Economic Community is not a private sector operation, but it is a governmental entity. It may receive the grain for, let us just use a hypothetical, delivered price of $6 per bushel. That does not mean they deliver it to the next level in the delivery system at $6. They may deliver it at $7 because they have rather fixed consumer prices from the port authorities. Is that right?

Dr. **Rivlin**. I do not know anything about port authorities in Rotterdam.

Chairman **Domenici**. I mean port authority in the very broad sense. It is the governmental entity that acts as the receiver.

Mr. **Fowler**. Our staff says that is basically correct.

PORT OF EXPORT FEE ON GRAIN

Chairman **Domenici**. It dawns on me that the agricultural community has a very, very vital and appropriate point, especially in these depressed markets. But I wonder if most of the world handles our grain in the same way as Europe, why we could not put the fee on grain at the port of export to pay for the inland transportation cost. Ultimately, if the world market got very competitive, you could still say it has a depressive effect upstream, but if prices are fixed overseas, it seems to me there would be a far greater chance that you could recoup the fee without affecting the farmer.

Does that make any sense?

Mr. **Fowler**. I think at this point in time, although I am not certain there is a competitive market, it is a buyer's market for grain between the United States, Canada, and I just do not know——

Chairman **Domenici**. I know that grain exports are not exclusively your issue. I would appreciate and I do not want you to spend a lot of time on it, if you could ask the Department of Agriculture to get us a response to my question.

[Material subsequently supplied for the record follows:]

As a legal matter, an export levy would probably raise Constitutional problems. Article I, section 9, clause 5, of the Constitution forbids a tax on exports from a State and the Supreme Court has held that this constitutes a ban on an export tax.

As a economic matter, we could not force an increased price on a foreign buyer regardless of market conditions, no matter what tax was placed on the grain. Under conditions of strong world demand, dealers in U.S. grain would certainly be able to pass cost increases on to foreign buyers, but there is no way to guarantee that they could do so under conditions of less bouyant demand. One could fix an add-on to the price of grain in, for example, Rotterdam, but there is no way to fix the price of grain itself. A relatively small number of dealers in U.S. grains plays a very important role in the world grain market, but there is too much competition for them to be able to dictate a price. Under weak market conditions, a fixed U.S. levy would simply lower the underlying price of grain. In short, from the point of view of the grain dealer, an export duty would have the same effect as an increase in barge rates. It is a cost increase which the dealer can and will pass on to his customers when market conditions permit him to do so. Under weaker market conditions, the delaer must absorb some or all of the cost increase or push some or all of it back on the barge operators and the country elevators from whom the grain is purchased in the first place. When the export dealers offer lower prices to the country, the elevators, in turn, offer lower prices to the farmer.

Chairman DOMENICI. Let me make a few points and then we will quit unless Senator Gorton has some additional questions.

In response to the issue that the administration's position might cause us to close ports, I think it should be stated that whether they have officially changed their position from the port fee as it was submitted orignially or not, that actually the administration has changed its position in that there is now a cap concept that goes along with the recoupment concept. There cap would be instituted to eliminate the wide disparities that might occur because of a Seattle-Portland type situation. The facts are that the Seattle-Portland situation is greatly ameliorated even if you have full recoupment as requested by the administration. The fee turns out to be 23 cents instead of 50 at the highest port.

The committee went further and reduced the percent recovered and the fee is at 7 cents. Just to put that in perspective, the price of grain delivered to Japan, that part of the world, is $150 a ton. If you doubled the committee's proposed fee, which is at 7 cents, you would then be talking about 14 cents on a delivered price of $150. I did not figure that percentage. That seems to me to be rather small in terms of hurting anybody.

Do you have any argument with those facts?

Mr. FOWLER. We essentially agree with that assessment.

CHARGES DIFFER BY AMOUNT OF COMPETITION

Chairman DOMENICI. Let me ask, perhaps Mr. Lave, who has done some work on the relationship of railways to inland waterways. We are always talking about the fact that the inland water shipping costs are going to go up, whether it is 3 cents, 10 cents, 27 cents. The economic argument for doinq this is not just to recoup as much of the cost of inland waterway as possible but to eliminate artificial disparities in the cost of transportation, thus making the all mode, including truck, rail, and waterway, more competitive and fairer. It seems to me if that argument is true, we should find something in the marketplace that says the following: Railroads charge less where they are in competition with the waterways, purely a question of survival, and charge proportionately too much where they have no competition for the same kind of products within their systems.

Is there any evidence of that?

Dr. LAVE. There is certainly a vast amount of evidence that charges do differ by the amount of competition. In the past the ICC worried about whether railroad had to charge "fully distributed costs" on all cargo, or whether they could go to "out of pocket costs" in some instances.

Chairman Domenici. That theory will work unless you have a monopolistic railroad system. When waterway fees are raised, railrates should come down as you move the further away from the waterway. If the railroad are picking up lost profits now on those segment, because they have to lower the rate, so much along segments near the waterway. That would not work if railroads are the sole source of transportation and do not have to react.

Is that basically right?

Dr. Lave. I think it is basically right that insofar as we are going toward the elimination of all Federal economic regulation of transportation, then the railroads will be free to lower price all the way down to marginal cost to compete with the waterways. That will certainly benefit the farmers in the Upper Midwest and some other areas. Clearly where you have less competition, then the railroads will not go down to marginal costs. However, there is immense competition from trucks and other forms of transportation. So the railroad rates could not get terribly hiqh.

There is an immense amount of competition within transportation within any portion of the economy.

Chairman Domenici. I would ask the Department of Transportation and the Director of CBO this question.

In the waning hours of the last session, the black lung bill passed the Senate. You are familiar with that, Dr. Rivlin?

Dr. Rivlin. Generally, yes.

NO INQUIRIES ON COMPETITIVE DISADVANTAGE OF COAL FEE

Chairman Domenici. Did any of the coal suppliers in this country ask the Department of Transportation what the competitive disadvantage was going to be for exporting coal by the imposition of a 50-cent-a-ton fee to the black lung disability trust fund?

Mr. Fowler. There were no such inquiries.

Chairman Domenici. Did CBO get any inquiry from Senators or Congressmen on the effect of the 50 cents on the future export potential of coal?

Dr. Rivlin. I do not remember that we did, Senator.

Chairman Domenici. Well, let me suggest that the black lung bill was passed with probably 3 hours' debate. The bill contains fees of 50 cents a ton for deep mined coal and 25 cents for strip mined. I did not hear anybody argue that we would surely hurt our consumers and we were going to put our coal out of competition in world markets. If you have full cost recovery on waterways, which is practically abandoned in Congress, our facts say that by the year 2000 full economy would impose a 25-cent-per-ton fee for American coal on the large waterway segment, where the coal moves the longest distance. It is about half of what we did on the floor of the Senate in about 4 hours.

It just strikes me that it does not make too much sense, especially if we could make the waterway system whole and build what we have to build for the future, to continue to say we will destroy the consumer and the potential for our exporting of coal with a 25-cent-a-ton fee, yet and we did not worry a bit about it when we put on a 50-cent fee. I do not ask you for any comment. This is my speech for the day.

I have a chart that I want to put in the record with reference to the fuel tax of 32.4 cents a gallon. Again, that amount is the maximum. The table shows the various segments and the increased shipping cost, per bushel wheat. The highest is from Minneapolis and it is 4 cents a bushel and the costs vary depending on the shipping point. On the Columbia, Snake, which somebody was talking about, it is nine-tenths of a cent. I would just make that a part of the record.

ESTIMATED INCREASE IN 1985 COST OF BARGING GRAIN FROM USER TAXES IN CENTS PER BUSHEL OF WHEAT OR SOYBEANS, 1979 DOLLARS

River and origin	Fuel tax 32.4 cents per gallon	Segment tax		
		No railroad response	50-percent railroad response	100-percent railroad response
Mississippi:				
Minneapolis, Minn.	4.27	6.95	6.54	6.33
Winona, Minn.	3.87	5.97	5.61	5.43
McGregor, Iowa	3.58	5.28	4.96	4.88
Clinton, Iowa	3.22	4.41	4.14	4.00
Burlington, Iowa	2.86	3.57	3.45	3.33
Hannibal, Mo.	2.57	2.85	2.68	2.57
St. Louis, Mo.	2.15	2.03	1.91	1.82
Cairo, Ill.	1.61	1.51	1.43	1.36
Portageville, Mo.	1.43	1.35	1.27	1.21
Osceola, Ark.	1.22	1.15	1.09	1.04
Memphis, Tenn.	1.10	1.03	.97	.93
Helena, Ark.	.95	.90	.85	.81
Perthshire, Miss.	.82	.77	.73	.70
Greenville, Miss.	.68	.64	.60	.57
Illinois:				
Seneca, Ill.	3.08	3.53	3.27	3.09
Ottawa, Ill.	3.04	3.47	3.20	3.02
Peoria, Ill.	2.78	3.02	2.81	2.66
Naples, Ill.	2.49	2.53	2.36	2.24
Ohio:				
Cincinnati, Ohio	2.64	2.26	2.12	2.05
Louisville, Ky.	2.39	2.08	1.95	1.88
Mt. Vernon, Ind.	1.91	1.74	1.63	1.57
Missouri:				
Sioux City, Iowa	7.05	9.12	8.18	7.52
Omaha, Nebr.	6.24	8.09	7.27	6.69
Kansas City, Mo.	4.23	5.63	5.09	4.72
Arkansas: Catossa, Okla.	3.86	18.70	14.04	11.48
Columbia-Snake:				
Lewiston, Idaho	2.43	3.96	3.74	3.61
Central Ferry, Wash.	1.94	3.12	2.95	2.85
Lyons Ferry, Wash.	1.70	2.84	2.69	2.59
Windust, Wash.	1.46	2.46	2.32	2.24
Umatilla, Wash.	.97	1.60	1.51	1.46
Biggs, Oreg.	.97	.77	.73	.70
Dallas, Oreg.	0	.55	.52	.50

Chairman **Domenici**. I think that is it.

Senator Gorton, do you have any further questions?

Senator **Gorton**. No further questions.

Chairman **Domenici**. I thank all three of you, and I am sorry Mr. Lewis could not be here but we understand.

We stand adjourned.

[Whereupon, at 12 noon, the committee adjourned, subject to the call of the Chair.]

WRITTEN COMMITTEE QUESTIONS TO WITNESSES AND THE RESPONSES

QUESTIONS TO THE CBO

Highway User Fees

One of the arguments against raising the federal gasoline tax is that it eclipses the states' ability to raise similar taxes.

Q. If highway user fees were raised the equivalent of 5 cents per gallon, approximately how much would you expect states to forfeit in fuel tax receipts?

A. The states could forfeit fuel tax receipts in two different ways. First, because the federal tax raises the price of fuel, the amount of fuel consumed would drop slightly and state tax receipts would fall along with it. This impact is minor, however: an increase of 5 cents per gallon would cause state motor fuel tax revenues to fall by about 1 percent (a 1983 loss of around $70 million in total) for all 50 states. Second, as the federal government increased the tax on motor fuel, it could make states reluctant to impose a second tax increase on the identical consumer good, thereby forcing states to defer such increases. There is no way to estimate the magnitude of this effect.

Q. What would be the budgetary impact of raising the equivalent of a 5 cents per gallon gasoline tax?

A. An increase of 5 cents per gallon for all motor fuel (including diesel fuel) would raise about $5.5 billion a year; a 5 cents per gallon increase in federal gasoline taxes alone would yield about $4.7 billion a year. The net budgetary effect depends on how these receipts are used. If highway spending were increased by an equivalent amount, outlays would eventually match receipts, leaving no net change in the federal deficit. For the first few years, however, outlays would lag receipts, creating a temporary increase in net receipts.

User Fees -- General

Q. The Administration is proposing to deposit receipts from Coast Guard user fees into the general fund, and treat it as proprietary receipts of the Department of Transportation. Receipts from aviation user fees would be deposited into the Airport and Airways Trust Fund. Could you comment on the budgetary impact of each of these approaches?

A. There is no difference in net budgetary impact. Whether placed in the general fund, a trust fund, or treated as proprietary receipts, the revenues show up on the budget. These various treatments may, however, restrict the flexibility by which these revenues can be shifted to other purposes, although this restriction is a practical limitation only if an earmarked fund has a surplus. This appears unlikely for these two programs if all appropriate costs are financed from the funds.

Q. What are the advantages and disadvantages of establishing a trust fund versus depositing receipts in the general fund?

A. The principal disadvantage of trust funds is the practical difficulty of shifting funding priorities as needs change. They can also hamper Congressional ability to control spending, particularly in the short term. On the other hand, their principal advantage is the assurance that user payments will indeed be dedicated to specific programs rather than general revenues. Trust funds also provide stable and reliable funding for long-term planning and construction. For example, the Highway Trust Fund enabled the Congress to make a national commitment to the Interstate Highway System. Although there are other ways to provide long-term funding assurance--multi-year appropriations, for example--trust funds can be reassuring to users asked to pay new fees. These issues are discussed more fully in CBOs report, Transportation Finance: Choices in a Period of Change, March 1978.

Q. In the case of the Highway Trust Fund, highway-related receipts began to decrease in the 1970s with the advent of fuel efficient cars and a reduction in auto use. Couldn't it be argued that highway spending has been held down, because highway users could not argue for increased highway spending without increasing highway user fees?

A. This is possible. During the 1960s, fuel use grew rapidly and inflation was low so that highway user fees were able to support a program that increased in constant dollars. This has not been the case throughout most of the 1970s, when inflation has been high and fuel use actually declined in some years. As a result, the Highway Trust Fund has not had unobligated balances available for road building, and highway spending may have been held down as a consequence.

On the other hand, in recent years the Congress has enacted obligation ceilings for the highway program, suggesting that other measures were required to hold the highway program to the size Congress desired. In addition, recently highway interest groups have pointed out the need for greater rehabilitation of roads. My impression is that these interests want a larger program and are willing to pay for it through increased user fees.

All things considered, while the existence of the Highway Trust Fund may have helped to hold down spending, the degree to which this has occurred is debatable. In any event, it is a crude form of budgetary control--one that may not match resources to changing needs.

QUESTIONS TO THE DEPARTMENT OF TRANSPORTATION

HIGHWAY USER FEES

QUESTIONS: I understand that the Department of Transportation's proposal to raise the equivalent of a 5 cent per gallon gasoline tax will be addressed by the Cabinet Council within the next few weeks.

1. To what extent would this proposal be tied to increased spending on highways? To increased spending for urban mass transportation?
2. In earmarking revenues for urban mass transportation, would you envision a trust fund mechanism, or a conventional authorization/appropriations approach?
3. What would be the budgetary impact of this proposal?

ANSWERS:

1. The increase would provide approximately $5 billion more per year. Approximately $4 billion of the increase would be used for highways and $1 billion per year would finance capital expenditures for mass transit.

2. The $1 billion per year for mass transit would go into the Highway Trust Fund and would be dedicated for use in funding transit capital projects. The funds would be appropriated on an annual basis from the Highway Trust Fund for the transit program.

3. There would be a positive impact on the budget of close to ten billion dollars over the next four years. This assumes that highway user charges are increasd an amount equivalent to a 5 cent increase in motor fuel fees and highway and transit capital investments are increased as we have proposed.

HIGHWAY USER FEES

QUESTION: The Administration's budget request does not propose raising motor fuel taxes or other highway related user fees.

1. If highway user fees remain constant over the next several years, what is the projected revenue shortfall for highway programs?
2. The Administration intends to submit its Cost Allocation Study this spring. Do you expect that the Cost Allocation will indicate that a re-distribution of highway related user fees is warranted, based on the Department of Transportation's research into the apportionment of highway costs among various users?
3. To what extent might increased truck user fees be passed onto the consumer?
4. To what extent might increased truck user fees result in freight traffic being diverted to railroads or other transportation modes?

ANSWER:

1. There will not be a shortfall in a Federal budgetary sense, since the level of Federal expenditures would always be keyed to revenues available from the Highway Trust Fund. However, if Federal highway user fees are not increased, states would have to develop their own revenue sources to meet an estimated $16 billion of costs associated with building and maintaining highways over the next several years.

2. The results of the Highway Cost Allocation Study will indicate a need to adjust highway user fees to better match cost responsibility with revenues for various classes of users. While modest adjustment may be indicated for a number of vehicle classes, the greatest need is to reduce user charges for single unit and the lightest combination

trucks and to increase user charges for the heaviest combination trucks. In addition, the study will suggest that some taxes, such as those on lubricating oil and on inner tubes, be eliminated because their yields do not justify their administrative costs. There are also a number of exemptions from highway user charges that the study will suggest be reexamined since they are not warranted by user charge criteria.

3. The extent to which increased truck user fees will be passed on to consumers is not easily determined because it is affected by both market structure and current economic conditions. Because traffic in the industry is currently down, we would expect that a somewhat larger share of any increase in user fees would be absorbed than would have been the case in the past. As demand for truck transportation increases with an improving economy, more of the increase might be passed on. There is also a great deal of variation in the ability of various segments of this diverse industry to pass cost increases on to consumers. While these factors preclude a precise answer to your question, we can say that any Federal truck user charge increases we have considered have been less than 2 percent of operating costs and have been far short of that for other than the heaviest class of trucks.

4. We do not believe there is the likelihood of any significant shifting of freight traffic from trucking to competitive modes from the imposition of increased user fees. We are assuming, of course, that we are talking about increases in fees that are within the general range of those currently under discussion and consideration. We believe this to be true primarily because the majority of traffic that would be highly competitive between rail and truck service has already shifted to trucking.

PURCHASING POWER OF THE HIGHWAY GAS TAX

QUESTION: Gasoline taxes have remained constant, at 4 cents per gallon, since 1959, while construction and maintenance costs have soared.

With the erosion of inflation, how much does the 4 cent per gallon gasoline tax buy today, compared with 1959?

ANSWER:

It is now worth less than one cent, about 0.9 cents.

COAST GUARD USER FEES

QUESTION: The Administration's budget request proposed depositing receipts from the Coast Guard user fees into the general fund, and treating revenues as proprietary receipts of the Department of Transportation.

1. Would this mean that Coast Guard user fee receipts could be used for any other transportation purpose, but not necessarily for Coast Guard expenses -- and not for any purpose other than transportation?
2. What is the rationale behind this approach? Why are Coast Guard user fees to be treated differently from other user fees such as aviation charges, which are dedicated to specific related programs?
3. Do you envision that the Coast Guard user fee proposal will meet with greater opposition from the maritime community if receipts are not dedicated to Coast Guard programs?

ANSWER:

1. Our Coast Guard user fee proposal does state that the Treasury would set up a proprietary receipts account to record the revenues realized by the user fees. All of the Coast Guard user fee receipts will be used to offset DOT outlays of which Coast Guard outlays are a part. Because the user fees will only recover about half of the Coast Guard's operating cost, in no way would there be excess collections to finance the operations of a non-Coast Guard agency.

2. The rationale for this approach stems from the fact that -- unlike the aviation trust fund -- we are seeking to recover only the actual costs of certain Coast Guard operations being carried out with funds already directly appropriated. There is a direct link between the cost of services performed and the rationale for the fees.

3. Some people have indicated to us that the use of a trust fund, such as the one used for aviation, would make more certain that user fee revenues would go to the Coast Guard. We feel that such a trust fund is neither necessary nor appropriate. The Coast Guard services are so multifaceted, and the users so diverse, that it would be difficult to put the Coast Guard on a trust fund basis. Trust funds are useful when there are long lead times between the commitment of funds and their expenditure as in the case of highway construction. In the case of the Coast Guard, user fees would be financing current operations and maintenance outlays that are essentially coincident in time with fee collection.

COAST GUARD USER FEES

QUESTION:	During last year's debate on Coast Guard user fees, there was some discussion as to whether fair and equitable cost allocations among various Coast Guard uses could be made. 1. What methodology is the Administration using to determine which Coast Guard costs are recoverable via user fees? 2. What criteria is the Administration using to devise an equitable fee schedule among various Coast Guard service users?

ANSWER:

1. We seek to recover only those costs which relate to Coast Guard operations and programs which benefit identifiable users. We will not seek to recover costs of such programs as military readiness or enforcement of laws or treaties because those programs primarily benefit the general public.

Once these recoverable operating costs are determined, they will be allocated to users. In some cases, the service is targeted - for example inspecting or documenting a particular vessel. Here a charge can be made at the time that the service is provided. In other cases the service is available to all users: for example a lighthouse, or a system of bouys on a river. Here we will use periodic fee collection mechanism.

2. (A) All marine users of operations or programs for which cost recovery is sought will be included.

(B) 100% of applicable costs will be recovered.

(C) Only actual cost will be recovered.

(D) To the greatest extent possible, separate fee schedules will be developed for separate classes of users to reflect the differences in the actual services they receive.

(E) Differences in numbers of vessels or facilities, size, weight, volume or other factors will be recognized where they reflect differences in service levels received.

(F) The cost and administrative simplicity of administering the fee program will be considered.

(G) We will not impose fees which would represent unacceptable economic impact or inequity.

COAST GUARD USER FEES - ROLES AND MSSION

QUESTION: You recently stated (in testimony before the Senate Appropriations Committee) that the Administration intends to submit the Coast Guard Roles and Missions Study to Congress by the end of March. To what extent will your Coast Guard user fee legislation take into consideration potential changes in the Coast Guard's role which may be indicated in this study?

ANSWER:

The Coast Guard user fee proposal deals with Coast Guard operations which provide actual service to specific users, and would recover only actual costs allocable to these users. Any changes brought about in those services, through the Roles and Missions study, or by any other decisions, can be directly and immediately translated into changes in these user fee schedules. Thus, if some function were discontinued, those costs would cease and would drop out of the allocated costs on which fee schedules would be based.

AVIATION USER FEES

QUESTION: The Administration's proposal to raise aviation user fees is a modification of the proposal submitted last session. Your previous proposal was criticized because of supposed inequities in the fee schedule, especially with respect to general aviation users.

1. To what extent does the Administration's revised proposal address the charges of inequities in the fee schedule?
2. What is the projected impact of the Administration's proposal on general aviation users?
3. To what extent does the Administration's proposal take into consideration benefits to the general public, such as economic development spurred by aviation activity?

ANSWER:

1. The charges of inequity in the Administration's initial fee schedule proposal resulted from a basic difference of opinion on the portion of the FAA's costs attributable to system users. It continues to be our view that civil aviation users should pay for 85% (58% air carriers, 27% general aviation) of the total FAA costs for developing, maintaining and operating the National Airspace and Airports System. Our revised proposal for general aviation fuel taxes reflects an effort to increase cost recovery from this segment of users without causing a serious disruption to them. To obtain the necessary revenues for the modernization program, we have increased the ticket tax in our revised proposal.

2. Our proposed fuel taxes will have minimal impact on general aviation users. In real dollar terms, it is less than the fuel tax that existed in 1970, when the tax rate was 7 cents per gallon. In

1982 dollars, that 7 cents per gallon would be the equivalent of more than 30 cents per gallon. The proposed fuel taxes would comprise a very small portion of the total cost of owning and operating a general aviation aircraft.

3. The Administration's user fee proposal would enable us to recover 85% of the total FAA costs for developing, maintaining and operating the National Airspace and Airport System from civil aviation users. The remaining 15% of FAA costs are attributable to military and government use of the system.

The primary beneficiaries of FAA services are the system users, even though important social and economic benefits do accrue to the general public. However, the existence of public benefits does not, by itself, prove the need or desirability of a major public subsidy. Similar statements could be made regarding a variety of systems, industries and programs which benefit the general public, such as the Federal Reserve system, the insurance industry, the telephone system, but which are not directly subsidized by the government.

AVIATION USER FEES

QUESTION:

1. If the aviation user fee proposal is not enacted, does the Administration plan to proceed with modernization of the air traffic control system; and how would this plan be financed?
2. What problems will occur if we do not proceed with modernization of the air traffic control system?
3. What other alternatives to the proposed National Airspace System Plan were considered, before recommending such an enormous, long range plan to modernize the air traffic control sytem?
4. Isn't it necessary to know the exact costs of any plan to modernize the air traffic control systems, before enacting a new user fee to finance this plan?

ANSWER:

1. If the aviation user fee proposal is not enacted it will not be feasible for us to proceed with the type of modernization we have proposed. The FAA cannot switch to the completely new, less manpower intensive method of operation embodied in our plan in a piecemeal basis. It must be accomplished through a carefully integrated technical transition. Since the system users are the primary beneficiaries of the modernization plan, we believe they should be willing to pay for it. If these beneficiaries do not support the plan, we do not believe that the general taxpayer should have to bear the burden.

2. There will be no immediate problems if we do not proceed with modernization of the air traffic control system. However, the current system of FAA facilities is rapidly becoming outdated and maintenance costs are rising. The FAA communications system is less efficient than

it could be and the costs of communications services are rising rapidly. Certain improvements can be achieved simply by adding more controllers and technicians to the system. But in the long term, this is ill-advised and in some respects wasteful, inasmuch as this approach also requires capital investment and simply postpones the problem.

In the long term, we will not be able to achieve the improvements in system safety capacity, productivity and economy which could be realized from implementing the modernization plan through actions such as the utilization of higher levels of automation, consolidations of major facilities and the application of rapidly-changing and lower-cost technologies in telecommunications. It is estimated that more than $25 billion will be saved by transitioning to the new system, as compared to continuing with present methods of air traffic management.

3. The plan resulted from the most comprehensive system analysis of the National Airspace System ever undertaken. That necessarily involved looking at virtually every alternative for accomplishing our objectives to provide safe and efficient air traffic control services.

The analysis consisted of an iterative process of defining services, systems and equipment, along with projections of required services, future technology and forecasts of traffic demand and mix. Options were analyzed and plans were created to incorporate capabilities within the framework of the separate elements constituting the National Airspace System.

From developed plans, system programs were formulated and evaluated against basic policy guidelines and budgetary implications. Additionally, each system examined served as the basis for analysis of every other system. This led to an iterative process of continuing reviews, insuring that projects were consistent with the system and between systems, leading to selection of a composit plan which provided the greatest future service at least cost.

An imporant aspect of this planning process is that it was not constrained by existing programs. Instead, it was developed by reviewing and analyzing many new alternatives.

4. The general cost of modernization ($8-10billion) has been known for some time. This has served as an adequate basis for initial user fee estimates. The FAA has developed detailed cost estimates for the facilities and equipment and research, engineering and development funding needed in the next five years. That information is available to the Committee. (See attached.)

FIVE YEAR RE&D PLAN-CURRENT YEAR DOLLARS MARCH 16,1982
FY 1983-1987

PROGRAM	TITLE	FY-83	FY-84	FY-85	FY-86/87	TOTAL FY83-87
01	SYSTEM	11877	18572	26165		126980
02	RADAR	0	0	0		0
03	BEACON	4279	5863	6380		26772
05	ASA	8375	5181	2169		15725
06	COMMUNICATIONS	10464	15451	15566		64921
08	AIRPORT/AIRSIDE	3081	6216	5805		27504
09	AIRPORT/LANDSIDE	0	0	0		0
10	OCEANIC	0	0	0		0
11	ATCSCC	0	0	0		0
12	ENROUTE	4033	5116	1659		11675
13	FSS	3419	4876	5104		24226
14	TERM	2946	3171	2169		11118
16	TECH	3533	3462	4236		26674
17	SATELLITE	0	0	0		0
21	SUPPORT	3099	9559	10016		42981
TOTAL		55096	77481	79269		370376
23	ADVANCED COMPUTERS	47000	156641	134542		470446
TOTAL		47000	156641	134542		470446
04	NAVIGATION	2515	4681	5155		19968
07	APPR & LANDING	2761	5791	6157		24269
TOTAL		5276	10472	11312		44237
15	WEATHER	8068	15427	19905		89175
TOTAL		8068	15427	19905		89175
19	AVIATION MEDICINE	3060	5161	4221		19490
TOTAL		3060	5161	4221		19490
18	AIRCRAFT SAFETY	13000	18368	17201		82540
TOTAL		13000	18368	17201		82540
20	ENVIRONMENT	2000	2438	2552		12408
TOTAL		2000	2438	2552		12408
GRAND TOTAL	R&D	133500	285984	269002	408186	1096672

Facilities and Equipment
Five Year Plan
FY 1983-1987
(Dollars in Millions)

Summary of Five Year Plan

FY 1983	FY 1984	FY 1985	FY 1986/1987
$725.0	$1,393.0	$1,407.0	$2,541.0

F+E Grand Total FY 1983-1987

$6,066.0

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CONTROLLABILITY OF ENTITLEMENTS

TUESDAY, MARCH 16, 1982

U.S. SENATE,
COMMITTEE ON THE BUDGET,
Washington, D.C.

The committee met, pursuant to notice, in room 6202, Dirksen Senate Office Building, commencing at 2:10 p.m., Hon. Rudy Boschwitz presiding.

Present: Senators Boschwitz, Andrews, Symms, Quayle, Hollings, Chiles, Biden, Johnston, Sasser, and Exon.

Staff present: Stephen Bell, staff director; Richard Bartholomew, senior analyst for human resources; Lizabeth Tankersley, minority staff director; and John Nelson, analyst for income security.

OPENING STATEMENT OF SENATOR BOSCHWITZ

Senator BOSCHWITZ. The Budget Committee hearing for this afternoon has to do with the controllability of entitlement and the budget of 1983. I feel quite clearly that the entitlement growth has to be controlled in some way in the event that we are going to achieve the goal of balancing the budget. The entitlements programs have grown quite rapidly, faster than the rest of the budget. They have filled some needs, on the other hand, that were not being filled prior to the establishment of many of those programs. But nevertheless, the figures have shown that in the period from 1960 to 1980, entitlements grew 1,100 percent while the budget grew at somewhat in excess of half of that rate. Defense grew somewhat less than 300 percent and other parts of the budget certainly did not grow at that rapid a rate.

ENTITLEMENTS CONSTITUTE APPROXIMATELY 50 PERCENT OF BUDGET

Entitlements, of course, continue to grow. The press quite properly informs people how to take best advantage of the entitlements program. This is a consumer guide, how to get more money out of social security, government benefits, medicare, plus a bunch of other programs. Of course, it is quite appropriate that our citizens should take advantage of the programs that have been crafted for them. But that too is part of the cause of the rapid rise of entitlements. Entitlements constitute, other than interest, approximately 50 percent of the budget and certainly there is no way that we are going to be able to bring about a balance unless those entitlements are in some way constrained.

92-469 O—82——6

Dr. Jack Meyer, we welcome you as our first witness. Dr. Meyer is the director and resident fellow at the Center for Health Policy Research of the American Enterprise Institute.

Senator Biden, Senator Johnston, do either of you have opening comments?

Senator BIDEN. I would like to apologize, at 20 past I have to go back to manage a bill that is on the floor of the Senate. But I am anxious to hear as much as I can while I am here.

Senator JOHNSTON. I have no opening statement.

Senator EXON. I have no opening statement.

Senator BOSCHWITZ. The chairman is unable to attend this morning, but he has supplied a statement that he would like inserted into the record.

STATEMENT OF CHAIRMAN DOMENICI

The subject of today's hearing, "Entitlements and the Controllability of the Federal Budget," deals with a critical issue before the Congress. In 1981, the Omnibus Reconciliation Act and other actions reduced Federal spending by at least $140 billion during the next three years—from fiscal year 1982 through fiscal year 1984. Even with these unprecedented reductions, the Federal budget is still growing about 10 percent per year. As all members of this committee are painfully aware, the current recession has caused the outlook for Federal deficits to worsen so badly that we now are faced with spending decisions this year that are even more painful than those made in 1981.

ENTITLEMENT PROGRAMS CONTINUE TO GROW

I want to summarize briefly some of the information from entitlement growth tables that are attached to my statement. Entitlement programs now constitute almost 60 percent of the total Federal budget. In 1976, $204 billion was spent on these programs. Today we have policies in place which will cost $477 billion in fiscal year 1983, a growth of 134 percent. Leaving those policies in place would allow growth of $100 billion from fiscal year 1983 to fiscal year 1985. The average annual compound growth of entitlement spending was 13 percent for the period 1976 to 1981.

The 1981 spending reductions touched entitlement programs very lightly. While discretionary appropriated programs were cut by an average on nearly 20 percent, the average 1981 cuts in entitlement programs were only about 3 percent. This means that entitlement programs will continue to grow by an average of 11 percent per year, even with the cuts made last year and assuming the fairly optimistic inflation path projected by CBO.

All this means that if there is to be further restraint in the growth of the Federal budget, the entitlement programs must bear a substantial part of the burden.

ENTITLEMENT IS AN AUTOMATIC GUARANTEED BENEFIT

I would define an entitlement as an automatic, guaranteed benefit due to an individual or an organization based on meeting qualifying characteristics, which are established by substantive Federal law. If you possess those characteristics, you have a right to receive the specified benefit from the Government, and that right is not dependent upon annual appropriations.

For example, if a student meets certain criteria for financial need, banks are authorized to extend to him or her a subsidized, government guaranteed loan. If an individual covered by Social Security reaches retirement age, dies or is disabled, that individual and his or her family will receive cash benefits established by law. Unemployed workers are entitled to payments if they or their employer contributed to their State-Federal unemployment compensation system. Holders of government securities must be paid specified rates of interest. The Federal government provides a variety of entitlement benefits to the elderly, the poor, and other individuals, such as those who suffer from black lung disease.

Throughout the past 50 years, especially during the last two decades, government has reached out to help needy individuals, rewarded those who have contributed to our nation, and joined together with individuals to pay for the financial security of tens of millions or our citizens. Last year, U.S. News and World Report estimated that 50 percent of the population stands eligible for some payment from the government.

MOST MAJOR ENTITLEMENT PROGRAMS ARE INDEXED

Most of the major entitlement programs also have a key common feature: Indexation. Benefits are regularly adjusted to offset inflation in the economy and thereby keep the real value of benefits constant. The Consumer Price Index [CPI] is generally used as the inflator. The CPI is now being revised, in large part because it has been found to have overstated housing costs, especially for the retired population.

Unforeseen price inflation has been the major factor in the impending Social Security financing crisis. When Congress reformed the program in 1977, no one ever imagined that inflation could increase benefit outlays so rapidly that less than 5 years later we would now be faced with inadequate trust fund balances.

Rapid growth in health care costs is driving the cost of medicare up at a annual rate of nearly 20 percent. Indeed health care costs have grown so rapidly that we now have serious questions about whether the medicare program can be continued without very major restructuring.

Any rise in interest rates increases spending for student loans and for interest on the Federal debt—the entitlement which has grown the fastest of all in recent years. We have a devastating circle of cause-and-effect in this whole area. Increasing deficits feed inflationary fears, which raise interest rates, which then increase deficit spending, and so on.

CBO estimates that Cost-of-Living Adjustments—COLA's, if you will—for retirement, disability, and food stamps alone will cost $293 billion between fiscal year 1982 and fiscal year 1987. Because these programs are designed to do so much for so many people, any attempt to alter their spending patterns have enormous political and financial implications. People, businesses, farmers, and all levels of government have made specific financial plans on the basis of entitlement promises. Clearly Congress must approach the issues of entitlements and controllability with due regard to their interests.

ENTITLEMENTS MUST BE SUBJECT TO RESTRAINT IN THEIR GROWTH

I believe Congress must deal with the deficits by reducing spending in all major categories or expenditures; by raising additional revenues; and by improving tax equity and fairness by closing loopholes and limiting special credits, exemptions, deductions, and preferences. As the biggest single category of Federal expenditures, entitlements must be subject to restraint in their growth, or we will fail to contain the staggering deficits everyone predicts.

If we have the courage, and I know we ultimately will, the Federal government can get its fiscal house in order and place entitlement programs on a sound footing. This will not only help to stop inflation—the cruelest tax of all—but also ensure that we will live up fully to the pledges we have made to those who have earned retirement benefits and those who must have other types of help.

INCREASES IN SOCIAL SECURITY BENEFITS, FEDERAL CIVIL SERVICE RETIREMENT, AND CONGRESSIONAL PAY -- 1970 to present

SOCIAL SECURITY	
Jan 1970	15%
Jan 1971	10%
Sep 1972	20%
Jun 1974	11%
Jun 1975	8%*
Jun 1976	6.4%
Jun 1977	5.9%
Jun 1978	6.5%
Jun 1979	9.9%
Jun 1980	14.3%
Jun 1981	11.2%

Total Growth in benefits (compounded) --205%

CIVIL SERVICE RETIREMENT	
Aug 1970	5.6%
Jun 1971	4.5%
Jul 1972	4.8%
Jul 1973	6.1%
Jan 1974	5.5%
Jul 1974	6.3%
Jan 1975	7.3%
Aug 1975	5.1%
Mar 1976	5.4%
Mar 1977	4.8%
Sep 1977	4.3%
Mar 1978	2.4%
Sep 1978	4.9%
Mar 1979	3.9%
Sep 1979	6.9%
Mar 1980	6.0%
Sep 1980	7.7%
Mar 1981	4.4%
Mar 1982	8.7%

Total Growth in benefits (compounded) --176%

Salary 1/1/70	$42,500
1975	$44,600
1977	$57,500
1979	$60,662

Total Salary increase (compounded): 43%

CPI change, 12/69 to 12/81: 149%

Average Gross Weekly Earnings Growth, 1970 to 1981: 121%

Senator BOSCHWITZ. Dr. Meyer, will you please proceed.

STATEMENT OF JACK A. MEYER, RESIDENT FELLOW IN ECONOMICS AND DIRECTOR, CENTER FOR HEALTH POLICY RESEARCH, AMERICAN ENTERPRISE INSTITUTE

Dr. MEYER. Thank you, Mr. Chairman.

With your permission, and in the interest of time, I would like to read a synopsis of my testimony and submit the full testimony for the record.[1]

HUMAN NEEDS AND SOCIAL PROBLEMS ON COLLISION COURSE

The effort to meet basic human needs and to improve persistent social problems in the United States has been on a collision course. Over the past two decades, rising Federal outlays for social programs have been our answer to the social problems besetting us. These rising outlays have emerged from a pattern of initiating new programs, broadening the coverage of existing programs, and increasing benefits per recipient. This pattern has been accommodated in the past by the willingness of the American people to cut defense outlays as a share of GNP and live with higher taxes and the adverse effects of large, continuous Federal deficits. But, in recent years, the tolerance of U.S. citizens for all of these ways of financing this growth in social spending has been wearing thin.

Through an expansion of social welfare spending, the United States has made implicit promises—and signed a kind of social contract—which it will find increasingly difficult to meet. We have enacted and enriched an array of spending programs that cannot be fully financed in today's climate that features an upturn in real defense outlays, a limit on the Federal tax burden, and a desire and commitment to reduce Federal deficits.

The large increase in social spending occurred at the same time as defense spending fell as a proportion of all Federal outlays. Indeed, about half of the build-up in social program outlays was rendered possible by the drop in defense outlays from about 10.5 percent of our national output in the mid-1950's to about 5 percent in the late 1970's.

GROWTH OF FEDERAL OUTLAYS

It is important to disaggregate the sum of all nondefense Federal outlays. One useful distinction isolates social programs from all other nondefense outlays. Over the past two decades the growth in nondefense outlays has stemmed primarily from the growth in social programs. The all other category was about the same percent of total outlays and of GNP in 1980 as in 1960. Moreover, social programs are unlikely to bear the brunt of the impact of budget cuts in the early 1980's. Even though some individual programs may be cut sharply, others such as social security that are much bigger will remain largely untouched, so that spending on these programs as a whole is likely to remain about the same proportion of all Federal spending and of GNP in 1985 as in 1981. For example, under President Reagan's recent budget projections, outlays associated with all entitlement programs would be 44.5 percent of total Federal outlays in 1985, the exact proportion of outlays accounted for by entitlements in 1981. If this development occurs, and defense spending plans remain intact or are beefed up further, then the only real battleground against sharply rising deficits would occur along the fairly limited turf occupied by nondefense, nonentitlement program areas such as general revenue sharing, transportation, agriculture, and community development.

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[1] See p. 89.

Outlays under both medicare and medicaid have been doubling in nominal terms about every 4 years. Even after adjusting for inflation and population growth, Federal outlays quadrupled under medicare and increased more than four-fold under medicaid between 1967 and 1981.

The food stamp program was expanded in 1971, but as table 2 shows,[1] real outlays per capita for this program have tripled since this date. Furthermore this growth far exceeds the growth in the number of beneficiaries. In medicaid, for instance, the number of recipients grew sharply in the early years—from 11.5 million in 1968 to 19.6 million in 1973. But, between 1973 and 1978, the increase was quite small—19.6 million to 22.2 million. Yet real outlays per capita continued to soar over this period, rising from $21 in 1973 to $31.50 in 1978. Thus, while the number of medicaid beneficiaries rose by 13 percent from 1973 to 1978, real per capita outlays rose 50 percent. This growth reflects the fact that in recent years over half the increase in medicaid outlays represents utilization increases by a fairly fixed population.

RETIREMENT PROGRAMS REPRESENT TICKING TIME BOMBS

It is important to recognize that a number of our retirement programs, as currently structured, represent ticking time bombs. Failure to make any alterations in the benefit structure facing future retirees or in the financing mechanisms will lead, ultimately, to an explosion of costs. For example, proposals to bail out the OASI fund by borrowing from the medicare fund represent a classic case of "robbing Peter to pay Paul."

As long as we treat the current age of retirement with full benefits, the current indexing formula, or the current low limits on earnings associated with social security as untouchable or sacrosanct, we will be faced with a grim choice between bankrupt funds—reneging on our social contract with future retirees—or steeply rising payroll taxes. Indeed, by the year 2020 under sanguine assumptions payroll taxes on employers and employees combined would reach a staggering level of about 21.5 percent under the present benefit structure. Moreover, meaningful reforms—instead of more Band-Aids—need not rob current retirees of any of their benefits. Instead, they would arrest the process whereby each succeeding cohort of retirees receives a higher living standard than the preceding groups. These changes could be phased in gradually over time without adversely affecting current recipients.

In the Federal Civil Service Retirement System for example real outlays per capita have roughly tripled over the last 12 years and now account for an estimated 30.8 percent of payroll for Federal civilian workers. But, according to the President's Commission on Pension Policy—1980—if this retirement system were funded according to the criteria established under the Employee Retirement Income Security Act—ERISA—that is to say, if the Federal Government practiced what it preached, outlays for retirement would soar to an estimated 79.8 percent of payroll. To put such a figure in perspective, consider that it is roughly double the proportion of payroll accounted for by all employee benefits, taken together, in the private sector. The combination of fully indexed cost-of-living adjustments, early retirement with full benefits, the generous treatment of social security income for dual beneficiaries, and other factors has contributed to the disparity between retirement benefits in the Federal and private sectors. That this situation represents a ticking time bomb is dramatized by the President's Commission's estimate of the unfunded liability for accrued benefits under the Civil Service Retirement Fund—$304.8 billion. A more recent estimate by Congressman John Erlenborn places this figure at $469.5 billion. When all nine Federal pension funds are aggregated, Erlenborn calculates an unfunded liability of $906.8 billion.

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[1] See p. 99.

IMPROVE WORK INCENTIVES

In poverty, income maintenance, and retirement programs, we need to pay more attention to improving work incentives for able-bodied, healthy individuals. High effective marginal tax rates on earnings discourage work effort; in a short-sighted effort to save current outlays through sharp benefit reduction rates associated with increased earnings, the Government has glued people faster to a state of dependency and, ironically, probably boosted Federal outlays over the long haul,

Regrettably, some of the disincentives for work by welfare recipients were augmented in the recent Omnibus Budget Reconciliation Act of 1981—Public Law 97-35—and the Reagan administration, which supported these changes, has proposed further steps in its fiscal year 1983 budget that would exacerbate this problem: In the 1981 legislation, Congress effectively repealed the "30 and a third" rule that at least provided some incentive for an AFDC beneficiary to increase work effort. Under the new law, the "$30 plus one-third" disregard may be applied only for the first 4 months of employment. After 4 months, every penny of net earnings is subtracted from welfare benefits, effectively negating any advantage to current recipients of continuing to work.

In evaluating the impact of the benefit reduction rate on labor supply, it is important to include not only the effect on the work effort of current recipients, but also the effect on families with slightly higher incomes who are newly qualified by the higher break-even lines associated with lower effective tax rates as well as the effects on the work effort of taxpayers who are supporting both groups.

Congress could improve work incentives for current program recipients either by lowering the benefit reduction rate under individual programs like AFDC or food stamps or by capping the cumulative tax rate for those receiving benefits from more than one program.

In addition, by leaving the cap on the earned income tax credit frozen at $500 per year—where it has been for 3 years—Congress has allowed any beneficial effect on work incentives associated with this program to erode in real terms.

The 1981 Reconciliation Act also allows States to institute required workfare programs for AFDC recipients and authorizes States to offer work supplementation programs. The administration and the Congress now seem to place more faith in requiring many AFDC reipients to work than in motivating them to work.

It seems unfortunate and unfair for the Federal Government to reduce the incentive to work through changes in programmatic features and then tell the States to find a way to get recipients working.

OFFER FINANCIAL INDUCEMENTS TO WORK

The judgment implicit in the 1981 act is that in female-headed families where no children are under 3 years old, the woman's daytime hours are always spent more productively at work than at home. I question this implicit premise. Society may save a few dollars today in public assistance payments as these women work at low-wage jobs, only to lay out many more dollars through the juvenile justice system or in other ways as children without much parental attention get into trouble. I would prefer to offer financial inducements to work so that those who wish to work will do so, but permit those household heads who believe that their family needs are better served if they postpone working to stay at home. We need to question the basic structure of a program like AFDC that makes benefits contingent upon both unemployment or under-employment by a male head and employment by a female head.

Indeed, when one examines recent and proposed changes in programs such as AFDC, food stamps, EITC, medicaid, and proposals that would limit CETA job training to AFDC recipients, one wonders whether the working poor are not getting the short end of the stick. One also wonders whether such people--if they cannot get marginal assistance, food, stamps, medicaid, or job training—will not be induced to go on welfare. Surely, this should not be the intent or thrust of public policy.

Public assistance recipients are not the only Federal beneficiaries to face stiff work disincentives. The strong penalty on earnings above $6,000 per year for social security recipients discourages work among the elderly who can work and wish to work. The Reagan administration had an effective plan for phasing out this earnings ceiling in its 1981 social security reform proposal, but this prudent phaseout was a casualty of the fate of the overall Reagan social security proposal.

Now, Mr. Chairman, these penalties on work are not only pennywise and pound foolish from the perspective of the Federal Government, but also dispiriting to beneficiaries whose sense of self-worth and usefulness would often be enhanced by voluntary participation in the work force. I hope we are not only interested in tax cuts and work incentives for the well to do.

FACING DIFFICULT CHOICES

Beginning about 2 years ago. the share of our resources devoted to defense spending started to increase, and today is about 6 percent. At the same time the rate of increase in social spending by the Federal Government has slowed, but not by nearly enough to avert huge ongoing Federal deficits, given planned defense spending and the limit to future tax increases enacted in the form of tax cuts for 1981–83 as well as the indexation of marginal tax rates beginning in 1985. The combination of these trends is likely to yield large Federal deficits even as sharp cuts in social programs are enacted.

Although these competing goals—holding down an increasing tax burden, reducing deficits to improve our chances for reducing inflation and interest rates, and increasing our defense capabilities—are not inherently irreconcilable, it may be extremely difficult—in both economic and political terms—to make significant progress on all three fronts simultaneously over a short period of time. It is vital (1) to establish priorities among these objectives, while indicating that none of the goals is being abandoned; and (2) to establish realistic timetables for these objectives to reduce the tensions between them.

PROGRAM OVERHAULS AND PRIVATE SECTOR INITIATIVES

The conflict between ongoing social needs and the diminished capacity of the Federal Government to address these needs necessitates (1) the development of fundamental reforms in the benefit structure and the delivery and financing mechanisms of social programs; and (2) a greater reliance on private sector initiatives to alleviate social problems.

To the extent that these opportunities for reform are missed or postponed continuously, efforts by the Federal Government to cap or reduce its own involvement in these programs will only shift the difficult choices between tax increases, benefit reductions, and price controls to lower levels of government. There are numerous examples in areas such as housing, child welfare, and health care where programs could be redirected away from costly delivery mechanisms to more effective, efficient strategies that are also more consistent with consumer choice and the dignity of program participants.

In conclusion, Mr. Chairman, I would like to say that the typical worker in the private sector of the U.S. economy has experienced a decline in real income in recent years as higher taxes and accelerating inflation eroded the purchasing power of employee compensation. Many program beneficiaries are insulated from this decline in real income by the indexation and tax-exempt status of their benefits. Some of these beneficiaries are not impoverished by any means.

This is not to argue that social programs serving nonpoor individuals lack justification entirely, but rather to observe that the process of raising the protective umbrella to cover more groups has led to a situation where some who are less needy are being protected—often in a tax-free, inflation-proof fashion—by others who are more needy and more vulnerable to both higher inflation and higher taxes.

This disparity between the experience of those who are assisted and those who are assisting has both diminished the willingness of workers to continue financing these programs and damaged the incentive to trade a status of dependency for work among benefit recipients who are able to work. Indeed, the adverse work incentives associated with some of the overlapping benefit programs have probably increased unemployment. If ways are not found to ease the strain on the working population who must support both the nonaged in a dependent status and the steadily swelling number of aged people, the result could be growing class and intergenerational conflicts in U.S. policy.

Senator BOSCHWITZ. Thank you very much, Dr. Meyer.

PREPARED STATEMENT OF JACK A. MEYER,* RESIDENT FELLOW IN ECONOMICS AND DIRECTOR, CENTER FOR HEALTH POLICY RESEARCH, AMERICAN ENTERPRISE INSTITUTION

The effort to meet basic human needs and to improve persistent social problems in the United States has been on a collision course. Over the past two decades, rising federal outlays for social programs have been our answer to the social problems besetting us. These rising outlays have emerged from a pattern of initiating new programs, broadening the coverage of existing programs, and increasing benefits per recipient. This pattern has been accommodated in the past by the willingness of the American people to cut defense outlays as a share of GNP and live with higher taxes and the adverse effects of large, continuous federal deficits. But, in recent years, the tolerance of U.S. citizens for all of these ways of financing this growth in social spending has been wearing thin.

The collision results from the fact that the need for human services will continue, and may even accelerate as the elderly population swells in the future at the same time as the public willingness dwindles to meet these needs through some combination of cuts in real defense outlays, higher taxes, and deficits. Recent skirmishes over proposed cuts in such programs as Social Security, Medicare, Medicaid, AFDC, and Food Stamps dramatize this collision, but are merely a warm-up exercise for the major battles looming ahead, as ongoing social needs conflict with other national economic and foreign policy objectives.

Through an expansion of social welfare spending, the U.S. has made implicit promises--and signed a kind of "social contract"--which it will find increasingly difficult to meet. We have enacted and enriched an array of spending programs that cannot be fully financed in today's climate that features an upturn in real defense outlays, a limit on the

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*The views expressed in this testimony are those of the author and do not necessarily represent those of the American Enterprise Institute, a nonprofit research and educational institution that does not take positions on public policy issues.

COMPOSITION OF OUTLAYS IN THE CBO BASELINE PROJECTION
($ billions)

CHART 1

	Actual	CBO Baseline Projections				Annual Average Compound Growth FY 1981-85		Outlays as % of Total Budget	
	FY 1981	FY 1982	FY 1983	FY 1984	FY 1985	Nominal	Real	FY 1981	FY 1985
Total outlays.........	660.5	740.1	808.9	888.6	971.0	10.1%	2.3%	100%	100%
National defense (F-050)* (except entitlements)									
Outlays............	145.9	174.9	197.0	220.0	243.5	13.7%	5.6%	22.1%	25.1%
Entitlements									
Retirement/Disability:									
Social Security...	139.6	155.0	170.4	184.8	200.6	9.5%	2.2%	21.1%	20.7%
All other..........	57.9	62.9	68.9	72.9	79.4	8.2%	1.0%	8.8%	8.2%
Total............	197.5	217.9	239.3	257.7	280.0	9.1%	1.9%	29.9%	28.8%
Medicare.............	42.5	48.9	57.3	66.7	77.0	16.0%	8.3%	6.4%	7.9%
Medicaid.............	16.8	17.9	20.1	21.9	25.1	10.6%	3.2%	2.5%	2.6%
Total............	59.3	66.8	77.4	88.6	102.1	14.5%	7.0%	9.0%	10.5%
Net Interest**........	68.7	85.0	106.5	129.6	143.1	20.1%	12.1%	10.4%	14.7%
Other Entitlements...	53.3	61.5	53.8	51.3	53.3	0%	-6.6%	8.1%	5.5%
Total Entitlements...........	378.8	431.2	477.0	527.2	578.5	11.2%	3.8%	57.4%	59.6%
All other Domestic/ International Affairs	152.3	161.5	153.6	161.7	172.1	3.1%	-3.6%	23.1%	17.7%
Less offsetting receipts.............	-16.5	-17.5	-18.7	-20.3	-23.1	8.8%	1.7%	-2.5%	-2.4%
*Department of Defense (except entitlements):	142.2	170.4	192.2	214.7	237.6	13.7%	5.6%	21.5%	24.5%
**Interest on the Debt:	95.5	118.6	146.9	177.3	195.6	19.6%	11.7%	14.5%	20.1%

NOTE: FY 1981 and future Medicare totals do not reflect OMB's new treatment of certain receipts as offsets to spending rather than revenues.

COMPOSITION OF ENTITLEMENTS FY 1976-85

(Outlays - $ billions)
(Fiscal Years)

Program	Actual 1976	1977	1978	1979	1980	1981	CBO Baseline* 1982	1983	1984	1985	Annual Average Compound Growth 1976-81	1981-85
Military retirement (050).. 1/	7.3	8.2	9.2	10.3	11.9	13.7	15.0	16.5	17.9	19.4	13%	9%
Farm price supports (350)..	1.0	3.8	5.6	3.6	2.7	4.0	11.1	5.4	2.9	3.8	30%	-1%
Railroad litigation (400)	---	---	---	---	---	2.1	0.6	---	---	---	N/A	N/A
Student loans (500).........	0.1	0.1	0.5	0.9	.4	2.3	3.1	3.7	4.1	3.6	82%	12%
Social services (Title XX) (500)......................	2.2	2.5	2.8	3.0	2.6	2.6	2.4	2.4	2.5	2.7	3%	1%
Medicaid (550)............. 1/	8.6	9.9	10.7	12.4	14.0	16.8	17.9	20.1	21.9	25.1	14%	11%
Medicare (550)............. 1/	17.8	21.5	25.2	29.1	35.0	42.5	48.9	57.3	66.7	77.0	18%	16%
Black lung (600)...........	1.0	1.0	1.1	1.6	1.8	1.8	1.8	1.8	1.8	1.8	12%	0%
Social security (600)......	73.9	85.1	93.9	104.1	118.6	139.6	155.0	170.4	184.8	200.6	13%	9%
Railroad retirement (600).. 1/	3.5	3.8	4.0	4.3	4.7	5.3	5.3	5.7	6.1	6.5	8%	5%
Federal civilian retirement (600)................ 1/	8.3	9.6	10.9	12.4	14.7	17.7	19.7	21.9	24.2	26.7	16%	11%
Unemployment compensation (600)......................	17.6	13.5	10.6	10.5	15.7	18.0	23.7	21.8	20.8	21.2	½%	4%
Supplemental security income (600)............. 1/	5.1	5.3	5.9	5.5	6.4	7.2	8.0	9.1	8.3	9.5	7%	7%
AFDC (600).................	5.8	6.4	6.6	6.6	7.3	8.5	8.1	8.3	8.5	9.0	8%	1%
Veterans compensation (700)......................	5.2	5.7	6.2	6.7	7.4	8.4	9.5	10.4	11.2	12.1	10%	10%
Veterans pensions (700).... 1/	2.9	3.1	3.2	3.5	3.6	3.8	3.6	3.5	3.4	3.4	5%	-3%
GI bill (700)..............	5.5	3.7	3.4	2.8	2.4	2.3	2.0	1.6	1.2	1.0	-15%	-19%
General revenue sharing (850)......................	6.2	6.8	6.8	6.8	6.8	5.1	4.6	4.6	4.8	5.1	-4%	0%
Net interest (900/950).....	26.7	29.9	35.4	42.6	52.5	68.7	85.0	106.5	129.6	143.1	20%	20%
Subtotal.................	198.7	219.9	242.0	266.7	309.5	370.4	425.3	471.0	520.7	571.6	13%	11%
Other entitlements.........	5.0	5.4	5.1	4.5	7.6	8.4	5.9	6.0	6.5	6.9	10%	-5%
Total, entitlements......	203.7	225.3	247.1	271.2	317.1	378.8	431.2	477.0	527.2	578.5	13%	11%
Food stamps................	5.6	5.4	5.5	6.8	9.1	11.3	11.5	12.5	13.0	13.9	14%	5%
Total, food stamps plus entitlements...........	209.3	230.7	252.6	278.0	326.2	390.1	442.7	489.5	540.2	592.4	13%	11%

*Estimates by the Congressional Budget Office of program costs in future years assuming no changes in existing law.
N/A = not applicable.   1/ Indexed by the CPI or one of its components

CHART 2

federal tax burden, and a desire and commitment to reduce federal deficits.

In my view, spending on social welfare programs has gotten out of control, and I say this as one who is sympathetic with the aims of almost all of these programs. Indeed, many of these programs have properly addressed the problems toward which they were aimed, and there is a considerable amount of "mythology" relating these programs to evils which they have not caused. The problem is that we can no longer afford the total cost of these programs, *as they are currently structured*. Moreover, this sobering reality *will not be significantly altered* by an all-out attack on "fraud and abuse." While I favor reducing fraudulent claims under social programs, I am not as sanguine as some observors about the *magnitude* of the *net* savings that are likely to emerge from a "crackdown."

It is tempting to attribute the growth of overall federal spending on social programs simply to the initiation of new programs and the phasing in of beneficiaries under existing programs. If these factors were largely responsible for outlay growth, we could stop initiating new programs or entitling new groups and presume that the spending growth would taper off. But, the growth of spending on social welfare programs in the U.S. reflects not only these factors, but also such factors as demographic changes which will be accelerating, not tapering off; the faulty design of some programs which builds in excessive cost increases, and lax claims review processes. These factors, taken together, will continue to increase both the number of eligibles and the benefits per recipient, at least until fundamental changes in program design and administration are developed.

Recent data from the U.S. Office of Management and Budget illustrate the dramatic growth in social spending. Total federal per capita real outlays for social programs (including all payments to individuals, education and training programs, and social services) doubled as a proportion of all federal outlays over the past two decades.

Table 1

Federal Government Outlays for Social Programs as a Proportion of Total Federal Spending

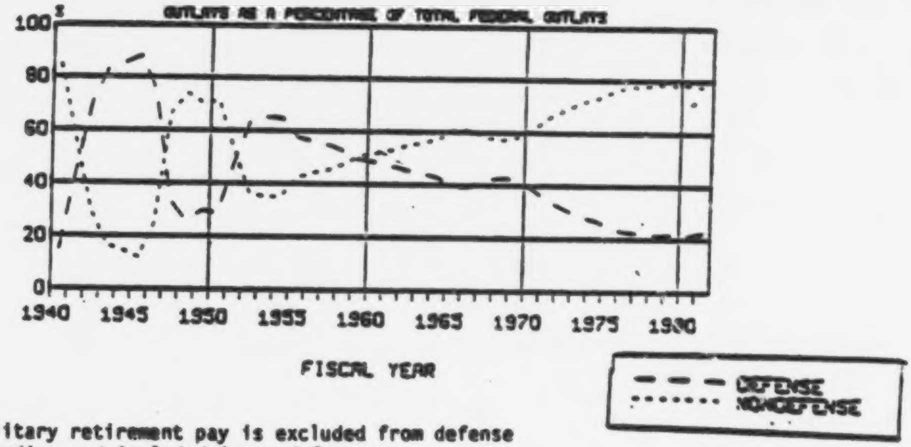
Fiscal year	Percent
1960	28.5
1967	33.4
1971	44.1
1981	55.5

Source: Calculated from data compiled by the Office of Management and Budget, 1981.

Thus, after adjusting for inflation and population growth, federal outlays for social programs rose from 28.5 percent of all federal outlays in 1960 to 55.5 percent in 1981.

Chart 1

FEDERAL OUTLAYS FOR DEFENSE AND NONDEFENSE PURPOSES*



*Military retirement pay is excluded from defense spending and included in nondefense.

Chart 1 shows that the large increase in social spending occurred at the same time as defense spending fell as a proportion of all federal outlays. Indeed, about half of the build-up in social program outlays was rendered possible by the drop in defense outlays from about 10 1/2 percent of our national output in the mid-1950's to about 5 percent in the late 1970s.

It is important to disaggregate the sum of all non-defense federal outlays. One useful distinction isolates social programs[1/] from all other non-defense outlays. Chart 2 reveals that over the past two decades the growth in non-defense outlays has stemmed primarily from the growth in social programs. The "all other" category was about the same percent of total outlays and of GNP in 1980 as in 1960. Moreover, social programs are unlikely to bear the brunt of the impact of budget cuts in the early 1980s. Even though some individual programs may be cut sharply, others such as Social Security that are much bigger will remain largely untouched, so that spending on these programs as a whole is likely to remain about the same proportion of all federal spending and of GNP in 1985 as in 1981. For example, under President Reagan's recent budget projections, outlays associated with all entitlement programs would be 44 1/2 percent of total federal outlays in 1985, the exact proportion of outlays accounted for by entitlements in 1981. If this development occurs, and defense spending plans remain intact or are beefed up further, then the only

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[1/] Social programs include all retirement programs (Social Security, railroad, federal employees and military); unemployment compensation; medical care; housing assistance; food and nutrition assistance; public assistance; education and training; student assistance; veterans benefits, and all other payments to individuals. Other non-defense program areas include international affairs; general science, space, and technology; energy; natural resources and environment; agriculture; commerce and housing credit; transportation; community and regional development; administration of justice; general government; general purpose fiscal assistance; interest, and off-setting receipts.

real battleground against sharply rising deficits would occur along the fairly limited turf occupied by non-defense, non-entitlement program areas such as general revenue sharing, transportation, agriculture, and community development. (See Chart 2). In fact, the Reagan administration's FY 1983 budget projects that the share of GNP accounted for by the sum of national defense, social insurance, and net interest outlays will edge upward from 14.9 percent in 1981 to an estimated 15.8 percent in 1987. By contrast, the share of GNP attributable to the "all other" portion of the federal budget would be cut in half under the Reagan plans, from 8.1 in 1981 to 4.0 percent in 1987.

A further disaggregation of these federal outlay figures reveals that the surge in social spending over the past two decades occurred despite little if any growth in programs targeted primarily to lower-income groups[4] since 1972. (See Chart 3). Programs accessible to all economic groups[5] --which include various retirement programs and Medicare--have accounted for the surge in spending over the past decade. Real

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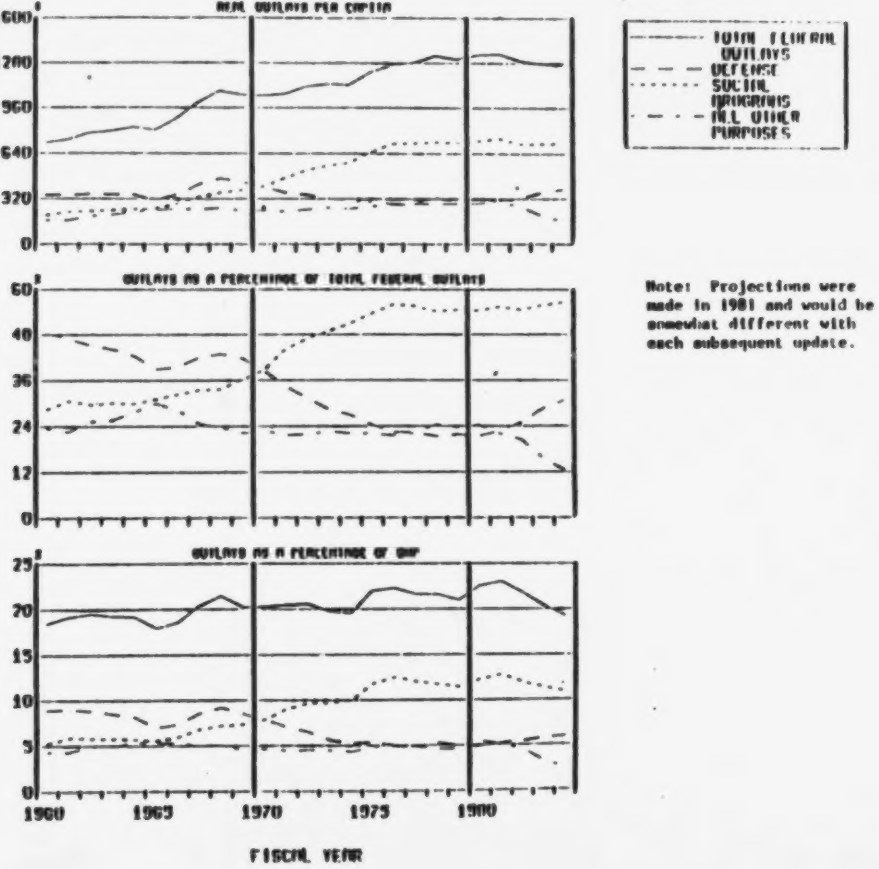
[4] Programs targeted primarily to lower economic groups include Medicaid, housing assistance; food and nutrition assistance; public assistance; elementary, secondary, and vocational education; and training, employment and social services.

[5] Programs that are accessible to all economic groups include social security and railroad retirement; federal employee and military retirement; unemployment compensation; medical care except medicaid; assistance to students including GI Bill; all other payments to individuals; higher education and research and education aids; and residual expenditures not included in payments for individuals.

FEDERAL OUTLAYS IN TOTAL, AND FOR DEFENSE, SOCIAL PROGRAMS, AND ALL OTHER PURPOSES, INCLUDING OFFICIAL PROJECTIONS TO 1984

CHART 2

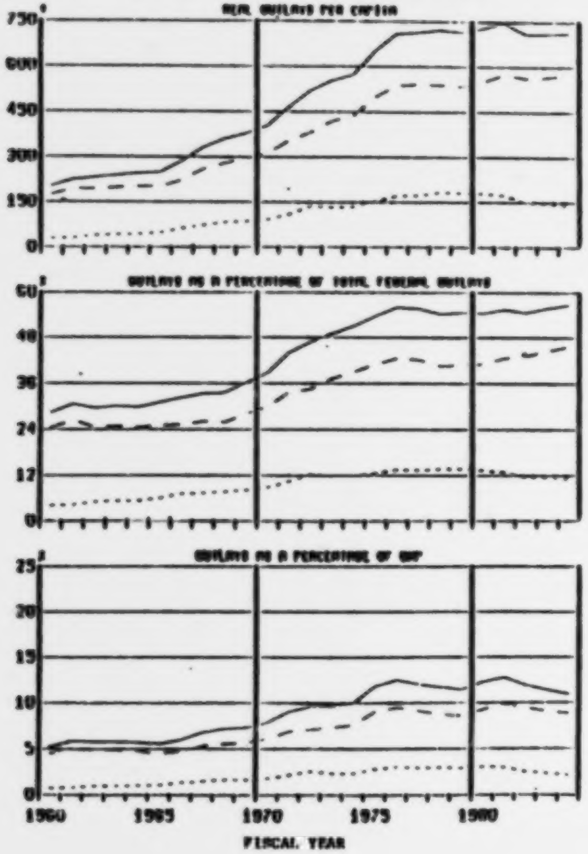


Note: Projections were made in 1981 and would be somewhat different with each subsequent update.

CHART 3

FEDERAL OUTLAYS FOR ALL SOCIAL PROGRAMS, AND FOR "A" AND "P" PROGRAMS[3]

OFFICIAL PROJECTIONS TO 1984



Note: Projections were made in 1981 and would be somewhat different with each subsequent update.

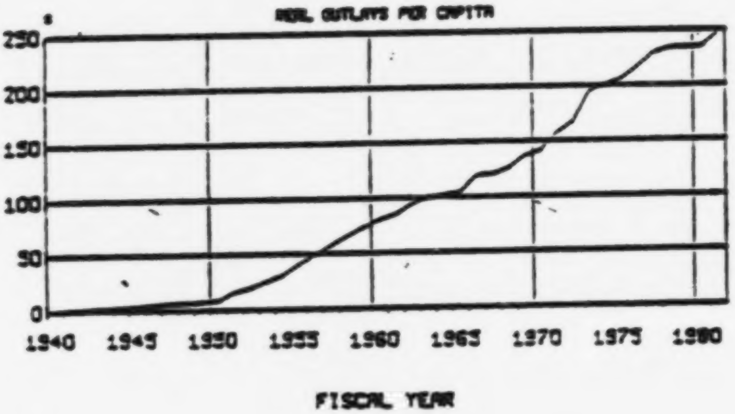
[3] Components of "A" and "P" programs refer to those available to all income groups versus those keyed to the poverty group and are defined in footnotes 4 and 5 on p. 6.

outlays per capita for poverty programs rose steadily during the 1960s and early 1970s as new beneficiaries were phased into these programs, but under current law projections, will be no higher in 1984 than they were in 1972. Spending under social programs available to all is scheduled to rise in the next three years while poverty-oriented programs drop as a proportion of total federal outlays over this period. It is worth noting however, that the Social Security and Medicare programs--while available to all income groups--have helped to reduce poverty in the U.S.

Data disaggregated one step further to the program area level illustrate the distinction between trends in poverty programs and trends in "all income class" social programs. Chart 4 shows the enormous growth

Chart 4

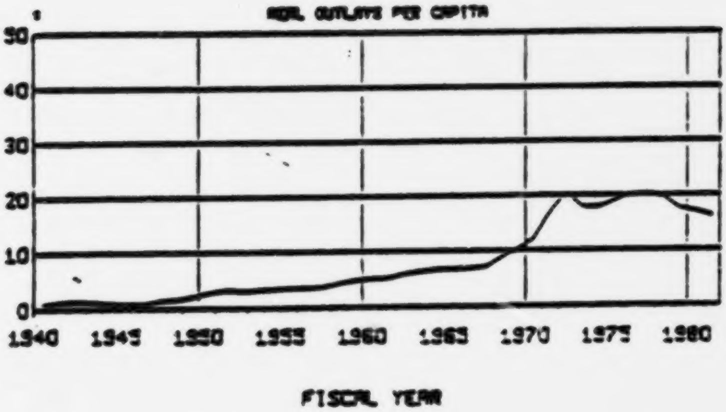
OLD-AGE AND SURVIVORS INSURANCE



in real outlays per capita under Old-Age and Survivors Insurance, and graphs of spending under the other two Social Security funds--Disability Insurance and Medicare--would show a similar trend. Between 1960 and 1980 real outlays per capita under OASI roughly tripled. By contrast, real assistance payments per capita under Aid to Families with Dependent Children (AFDC) reached a peak in 1972 and have levelled off since then. (See Chart 5). In FY 1981 AFDC outlays were $8.5 billion, and under President Reagan's proposed FY 1983 budget, outlays for AFDC are scheduled under current law to decline to $7.2 billion in FY 1983 and stay at about that level through FY 1985. Outlays for AFDC would fall further to $5.9 billion in FY 1983 under Reagan's proposed legislation for AFDC. In any case, despite all the rhetoric about welfare costs, outlays for AFDC will comprise no more than 1 percent of the Federal budget in the early 1980's.

Chart 5

AID TO FAMILIES WITH DEPENDENT CHILDREN



One sector where the distinction between poverty social programs and other social programs breaks down, however, is health care. Outlays under both Medicare and Medicaid have been doubling in nominal terms about every four years. Even after adjusting for inflation and population growth, federal outlays quadrupled under Medicare and increased more than four-fold under Medicaid between 1967 and 1981 (see Table 2).
The Food Stamp Program was expanded in 1971, but as table 2 shows, real outlays per capita for this program have tripled since this date. Furthermore, this growth far exceeds the growth in the number of beneficiaries. In Medicaid, for instance, the number of recipients grew sharply in the early years (from 11.5 million in 1968 to 19.6 million in 1973). But, between 1973 and 1978, the increase was quite small (19.6 million to 22.2 million). Yet real outlays per capita continued to soar over this period, rising from $21.00 in 1973 to $31.50 in 1978. Thus, while the number of Medicaid beneficiaries rose by 13 percent from 1973 to 1978, real per capita outlays rose 50 percent. This growth reflects the fact that in recent years over half the increase in Medicaid outlays represents utilization increases by a fairly fixed population.[6]

It is important to recognize that a number of our retirement programs, as currently structured, represent ticking time bombs. Failure to make any alterations in the benefit structure facing future retirees or in the financing mechanisms will lead, ultimately, to an explosion of costs. For example, proposals to bail out the OASI fund by borrowing

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[6] See Frank A. Sloan, "The Rising Cost of Medicaid," forthcoming paper.

Table 2

The Growth of Federal Outlays for Selected Social Programs, 1967-81

(real per capita outlays. 1972 dollars
and as a percent of total federal outlays)

	Food Stamps		Medicare		Medicaid	
Fiscal years	real per capita dollars	Percent of Total Outlays	real per capita dollars	Percent of Total Outlays	real per capita dollars	Percent of Total Outlays
1967	$0.70	0.1%	$21.50	2.2%	$7.40	0.7%
1971	7.80	0.7				
1981	22.20	1.6	84.40	6.3	33.00	2.5

Source: Office of Management and Budget Data from the Medicare fund represent a classic case of "robbing Peter to pay Paul." As long as we treat the current age of retirement with full benefits, the current indexing formula, or the current low limits on earnings associated with Social Security as untouchable or sacrosanct, we will be faced with a grim choice between bankrupt funds (reneging on our social contract with future retirees) or steeply rising payroll taxes. Indeed, by the year 2020, payroll taxes on employers and employees combined would reach a staggering level of about 21 1/2 percent under the present benefit structure.[7] Moreover, meaningful reforms (instead of more Band-Aids) need not rob current retirees of any of their benefits. Instead, they would arrest the process whereby each succeeding cohort of retirees receives a higher living standard than the preceeding groups. These changes could be phased in gradually over time without adversely affecting current recipients.

In the Federal Civil Service Retirement System real outlays per capita have roughly tripled over the last twelve years and now account for an estimated 30.8 percent of payroll for federal civilian workers. But, according to the President's Commission on Pension Policy (1980), if this retirement system were funded according to the criteria established under the Employee Retirement Income Security Act (ERISA)--that is to say, if the federal government practiced what it preached--outlays for retirement would soar to an estimated 79.8 percent of payroll.[8] To put such a figure in perspective, consider that it is roughly double the proportion of payroll accounted for by all employee benefits, taken together, in the private sector.[9] The combination of fully-indexed cost-of-living adjustments, early retirement with full benefits, the generous treatment of Social Security income for dual beneficiaries, and other factors has contributed to the disparity between retirement benefits in the federal and private sectors. That this situation represents a ticking time bomb is dramatized by the President's Commission's estimate of the unfunded liability for accrued benefits under the Civil Service Retirement Fund--$304.8 billion. A more recent estimate by Congressman John Erlenborn places this figure at $469.5 billion. When all nine federal pension funds are aggregated, Erlenborn calculates an unfunded liability of $906.8 billion.[10] The Reagan administration deserves some credit for its attempt to address one aspect of this problem in its FY 1983 budget proposals. To correct the inequity that finds current retirees with lower annuities than those with the same work history who retired earlier, the Reagan budget adjusts future civil service retirement annuities by the lesser of the increase in the CPI or the increase in General Schedule pay for Federal employees, and holds down future adjustments for these annuitants until they fall in line with the benefits of new retirees with comparable service.[11]

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[7] This figure is for OASDHI. It is based on projections of the 1981 Trustees of the Social Security Administration that assume for the long run an inflation rate of 4.0 percent, an unemployment rate of 5.0 percent, and real GNP growth of 2.7 percent. Less optimistic assumptions, of course, would mean that it would take an even steeper increase in payroll taxes to maintain the current benefit structure.

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[8] President's Commission on Pension Policy, Federal Pension Programs," January 1981, pp. ii-iii, p. 8.

[9] This proportion was estimated to be 37.1 percent for 1980. See U.S. Chamber of Commerce, Employee Benefits 1980.

[10] Congressman John Erlenborn, News Release, January 19, 1982.

Regrettably, however, the latest Reagan proposal for Federal pay dropped the administration's 1981 request that Federal pay determinations be broadened to include total compensation comparability rather than annual pay adjustments based on salary alone. Other reforms with support from GAO and a series of Presidential commissions, such as the broadening of the scope of the Professional, Administrative, Technical and Clerical workers survey, are also missing from the administration's latest proposal.

The need to improve work incentives

In poverty, income maintenance, and retirement programs, we need to pay more attention to improving work incentives for able-bodied, healthy individuals. High effective marginal tax rates on earnings discourage work effort; in a short-sighted effort to save current outlays through sharp benefit reduction rates associated with increased earnings, the government has glued people faster to a state of dependency and, ironically, probably boosted federal outlays over the long haul.

Regrettably, some of the disincentives for work by welfare recipients were augmented in the recent Omnibus Budget Reconciliation Act of 1981, (P.L. 97-35), and the Reagan administration, which supported these changes, has proposed further steps in its FY 1983 budget that would exacerbate this problem. In the 1981 legislation, Congress effectively repealed the

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[11] See Budget of the United States Government, FY 1983, pp. 5-147-148.

"30 and a third" rule that at least provided some incentive for an AFDC beneficiary to increase work effort. Under the new law, the "$30 + 1/3" disregard may be applied only for the first four months of employment. After four months, every penny of net earnings is subtracted from welfare benefits, effectively negating any advantage to current recipients of continuing to work. Moreover, the expense disregard used to calculate net earnings was standardized and capped so that over time its value will shrink, further dampening the incentive to work. The work expense disregard was set at $75 per month, and the child care deduction limited to $160 per month per child for full-time work throughout the month. Also, the law imposed an eligibility limit restricting benefit payments to families whose gross family income does not exceed 150 percent of the states' need standards. The Act also requires states to assume that eligible parents receive advance payment of the Earned Income Tax Credit, tightens the family resource limits by lowering the cap on assets (other than a home and one car) from $2,000 to $1,000, and allows states to consider as income the value of Food Stamps and rent or housing subsidies to the extent that these amounts duplicate food or housing components in the state's standard of need. The Reconciliation Act also institutes retrospective budgeting and monthly reporting, and requires states to correct payment errors promptly.

With regard to the 150 percent limit for initial financial eligibility, it is worth noting that a recent Congressional Research Service study found that in more than one-half of the states, the new law's gross income limit is below the U.S. Census Bureau's 1980 poverty threshold of $548 per month.[12] A CRS survey of states showed that the new gross annual earnings limits would cut earned income limits by about a third.

In evaluating the impact of the benefit reduction rate on labor supply, it is important to include not only the effect on the work effort of current recipients, but also the effect on families with slightly higher incomes who are newly qualified by the higher break-even lines associated with lower effective tax rates as well as the effects on the work effort of taxpayers who are supporting both groups. Studies of labor supply effects of the AFDC program indicate clearly that the effect on current recipients of higher effective tax rates is negative.[13] Increasing the "tax rate" by 10 percentage points, for example, is predicted in two studies to lower employment rates by an estimated 1.4 - 2.1 percentage points.[14] Studies which include the other groups are more inconclusive, as the effects on labor supply of newly-qualified AFDC recipients seem to offset the effects on existing recipients to a significant degree.[15]

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[12] See Vee Burke, AFDC FY 1982 Budget Cuts, Congressional Research Service, February 1982, p. 6.

[13] See, for example, Irwin Garfinkel and Larry Orr, "Welfare Policy and Employment Rate of AFDC Mothers," National Tax Journal, June 1974 27(2), pp. 275-84; Robert Williams, "Public Assistance and Work Effort," Princeton, N.J.: Industrial Relations Section, Princeton University, 1975; and Daniel H. Saks, "Public Assistance for Mothers in an Urban Labor Market," Princeton, N.J.: Industrial Relations Section, Princeton University, 1975.

[14] Garfinkel and Orr, op. cit., and Williams, op. cit.

[15] For a thorough review of the literature on this subject, see Sheldon Danziger, Robert Haveman, and Robert Plotnick, "How Income Transfer Programs Affect Work, Savings, and the Income Distribution," Journal of Economic Literature, vol. XIX (September 1981), pp. 975-1028.

A recent survey of the literature on work disincentive features of social programs by Danziger, Haveman, and Plotnick indicates that relative to a counterfactual of zero public transfers, the combination of all social insurance and public assistance programs reduces the work hours of transfer recipients by 4.8 percent of the total work hours of all workers.[16] The authors suggest that this is likely to be an upper boundary because private transfers would have their own work disincentives. The extent to which this reduction in work by current recipients would be offset by the effects on the work effort of others is uncertain.

In evaluating program changes, we should understand that some changes may save the federal government a few dollars today, but could cost the taxpayers more tomorrow. Proponents of these changes argue that with the prior incentives in place, the number of welfare recipients who "worked themselves *off* welfare" was not very impressive; but this is not the proper criterion. Many people who were still "on welfare" were *less dependent on welfare* as earnings from work provided *a relatively larger proportion* of their total incomes and public assistance benefits provided *a relatively smaller share* of their total incomes. As taxpayers, we should not prefer a higher total welfare bill with a marginally smaller caseload to a lower total price tag with a marginally higher caseload. It is not the number of people "on welfare" that we should focus on as much as how many of them are on the path toward *reduced dependency* on the taxpayers (if they are able to work) and a relatively greater--even if not yet total--reliance on their own individual work effort.[17]

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[16] See Danziger, Haveman, and Plotnick, *op. cit.*, p. 996.

A similar trend is evident in changes in the Food Stamp program where the earnings disregard was lowered marginally from 20 percent to 18 percent in 1981, and a current proposal by the Reagan administration would eliminate the disregard altogether and increase the benefit reduction rate from 30 to 35 percent.

Congress could improve work incentives for current program recipients either by lowering the benefit reduction rate under individual programs like AFDC or Food Stamps or by capping the cumulative tax rate for those receiving benefits from more than one program.

In addition, by leaving the cap on the Earned Income Tax Credit frozen at $500 per year (where it has been for three years), Congress has allowed any beneficial effect on work incentives associated with this program to erode in real terms.

The 1981 Reconciliation Act also allows states to institute required "workfare" programs for AFDC recipients and authorizes states to offer a work supplementation program. The administration and the Congress now seem to place more faith in requiring many AFDC recipients to work than in motivating them to work. It seems unfortunate and unfair for the federal government to reduce the incentive to work through changes in programmatic features and then tell the states to find a way to get recipients working.

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[17] For a comprehensive analysis of the issue of work incentives in social programs, see Vee Burke, "Work Disincentives in Income-Tested Programs," Congressional Research Service Report No. 80-158 EPW, October 24, 1980.

The concept of workfare treats welfare benefits as a kind of "stigma" or punishment that must be "worked off." In this sense, it is worth recalling that despite the popular mythology depicting lazy men refusing to work, only about 10 percent of all AFDC families have a father in the home. While 26 states offer the AFDC-UP program for families where a father is unemployed, only 5 percent of all AFDC families in December 1980 were covered under this program.

The judgment implicit in the 1981 act is that in female-headed families where no children are under three years old, the woman's daytime hours are always spent more productively at work than at home. I question this implicit premise. Society may save a few dollars in public assistance payments as these women work at low-wage jobs, only to lay out many more dollars through the juvenile justice system as children without much parental attention get into trouble. I would prefer to offer *financial inducements* to work so that those who wish to work will do so, but permit those household heads who believe that their *family needs* are better served if they postpone working to stay at home. We need to question the basic structure of a program like AFDC that makes benefits contingent upon both *unemployment* or *under-employment* by a *male* head and *employment* by a *female* head.

Finally, other features of public assistance programs damage work incentives by treating applicants for public assistance who are working less generously than current recipients (AFDC denies the work incentive bonus to applicants) and by ending eligibility abruptly when a threshold is reached (e.g., Medicaid and AFDC-UP). The latter feature discourages full-time work by the father of a welfare family and can cause the loss of hundreds of dollars of medical benefits when one dollar is earned at the threshold line. The former work disincentive could be ended by extending AFDC eligibility to the break-even level of earnings for everyone, while the full-time work disincentive under AFDC-UP could be reduced by a straight earnings test for two-parent families combined with dropping the requirement that a father be unemployed in order to receive benefits.[18/] We need to alter features of our welfare system that either encourage families to break up in order to receive assistance or encourage unemployment for program eligibility. Indeed, when one examines recent and proposed changes in programs such as AFDC, Food Stamps, EITC, Medicaid, and proposals that would limit CETA job training to AFDC recipients, one wonders whether the working poor are not getting the short end of the public policy stick. One also wonders whether such people--if they cannot get marginal public assistance, food stamps, Medicaid, or job training--will not be induced to go on welfare. Surely, this should not be the intent or thrust of publi- policy.

Public assistance recipients are not the only federal beneficiaries to face stiff work disincentives. The strong penalty on earnings above $6000 per year for Social Security recipients discourages work among the elderly who can work and wish to work. The Reagan administration had an effective plan for phasing out this earnings ceiling in its 1981 Social Security reform plan, but this prudent phase-out was a casualty of the fate of the overall Reagan Social Security proposal.

Skilled workers in manufacturing industries also faced a strong work disincentive prior to 1981 from the cumulative structure of Unemployment

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[18/] See Vee Burke, op. cit., pp. 83-84.

Compensation, Trade Adjustment Assistance, and private Supplemental Unemployment Benefits. The changes proposed by President Reagan and adopted by the Congress helped reduce this work disincentive and end the situation in which many workers on layoff actually received more after-tax income than if they had been working.

These penalties on work are not only penny-wise and pound foolish from the perspective of the federal government, but also dispiriting to beneficiaries whose sense of self-worth and usefulness would often be enhanced by voluntary participation in the work force.

Facing difficult choices

Beginning about two years ago, the share of our resources devoted to defense spending started to increase, and today is about 6 percent. At the same time the rate of increase in social spending by the Federal government has slowed, but not by nearly enough to avert huge ongoing federal deficits, given planned defense spending and the limit to future tax increases enacted in the form of tax cuts for 1981-83 as well as the indexation of marginal tax rates beginning in 1985. The combination of these trends is likely to yield large federal deficits even as sharp cuts in social programs are enacted. Some experts have estimated that such deficits would be in the range of $200 billion per year in the mid-1980's, or even higher to the extent that additional defense spending increases beyond those currently projected are undertaken.

Some observers have discounted the importance of these projected deficits on the grounds that either there is enough slack in our economy to render deficits relatively harmless or that the deficits continue to be a relatively small percentage of our GNP, smaller than for many other countries. But, while deficits may be less problemmatical in a slack than a bouyant economy, the dangers of deficits cannot be easily dismissed. First, because of the rise in the so-called full-employment unemployment rate, our definition of "slack" has changed over time, so that there is a tendency to believe, mistakenly, that we have enough slack in the economy to render sizeable deficits relatively harmless. Higher rates of unemployment today than in earlier periods of our history are a reflection not only of slack demand, but also of demographic changes in the labor force and of extended voluntary search for work. The latter development has probably been fostered by the adverse work incentives incorporated in some of our social programs.

Second, the share of GNP accounted for by deficits must be measured against the available pool of savings. If we had a savings rate as high as the Federal Republic of Germany or Japan, there would be less reason for concern about deficits of the magnitude that are projected through the mid-1980's. But, in our low-savings economy, such deficits would use up a very large proportion of the total pool of savings, and would surely limit housing and capital formation. The contention that the savings rate will rise enough to make room for such deficits, thereby averting higher interest rates, is more of a hope than a reality. Instead, we are likely to see a squeeze on private investment which, in turn, will both complicate the task of our monetary authorities and contribute ultimately to lower productivity and supply shortfalls as private investment projects are postponed. What I am suggesting is that federal deficits add to inflationary pressures if they are monetized because they constitute dissaving and are unlikely to be offset by sharply higher rates of personal and business saving. But, if deficits do not lead to a more expansive money supply, they will drive up interest rates, with an adverse impact on housing, automobile purchases, thrift institutions, etc.

The process of holding back an upturn in the tax burden is likely to conflict with our desire to reduce federal deficits in the ensuing years, unless deep cuts in federal nondefense outlays are accomplished. I am not advocating such cuts; rather, I am observing that they would be necessary to reconcile the tension among the objectives inherent in current government policy. Moreover, the more we want to expand the share of our output devoted to national defense, the more Draconian the cuts in nondefense outlays would have to be to reconcile the tax, defense, and deficit objectives. Indeed, the treatment of defense spending and Social Security as untouchable or sacrosanct, together with the "uncontrollable" nature of interest payments in the short run, leaves a relatively small (and shrinking) piece of the federal pie that is available for budget cutting. In 1981 the share of the budget accounted for by national defense, Social Security, and net interest was 55.8 percent. Under the proposed Reagan budget, the corresponding figure in 1983 would be 64.8 percent, and by 1985, 68.5 percent. If Medicare were included in the 1985 projection, an estimated 75.8 percent of the federal budget would be in this "untouchable" category. This would leave only a fourth of the total for budget cutting, and this one-fourth share, including all of the social programs geared to the non-elderly, would require radical surgery indeed if we proceed with our current defense and tax plans, and still hope to avoid massive deficits. In my view, the burden should be spread more evenly.

Although these competing goals--holding down an increasing tax burden, reducing deficits to improve our chances for reducing inflation and interest rates, and increasing our defense capabilities--are not inherently irreconcilable, it may be extremely difficult (in both economic and political terms) to make significant progress on all three fronts simultaneously over a short period of time. It is vital 1) to establish priorities among these objectives, while indicating that none of the goals is being abandoned; and 2) to establish realistic timetables for these objectives to reduce the tensions between them.

A New Strategy: Program Overhauls and Private Sector Initiatives

The conflict between ongoing social needs and the diminished capacity of the Federal government to address these needs necessitates 1) the development of fundamental reforms in the benefit structure and the delivery and financing mechanisms of social programs; and 2) a greater reliance on private sector initiatives to alleviate social problems.

Program Redesign

By delivering an adequate quantity and quality of social services at a lower resource cost, we can lessen the need to respond to the evaporation of available funds by 1) cutting eligibility; 2) reducing benefits per eligible recipient; and 3) putting price controls or rate ceilings on service providers that lead to a reduction in the availability and/or quality of the services. None of these strategies is desireable.

Regrettably, structural reforms in social programs often fall victim to short-term budgetary concerns. Thus, long-term budgetary relief is sacrificed to the reluctance of any current policy regime to forego short-term savings or to incur a temporary upturn in outlays. Over the past decade, welfare reform proposals were discussed and discarded. The plans entailed higher costs initially as a result of lower benefit reduction rates (welfare "tax rates") and more equal benefits across geographic areas, but held out promise of an eventual slowdown in outlays as improved work incentives encouraged welfare recipients to substitute work for dependency.

A similar problem faces current market-oriented reform proposals in health care. Currently, cost sharing in Medicare and Medicaid occurs at the "back-end" when people have incurred huge medical bills and is quite limited for routine services at the "front-end." Federal aid to the poor is inequitable, systematically excluding millions of people on the basis of family status. Open-ended tax subsidies encourage first-dollar insurance coverage for a broad variety of health services which in turn has led to increased demand for services. We have "stacked the deck" against a variety of innovative delivery systems that promise to compete with the dominant delivery system. And we have entangled the health care system in a labyrinth of largely ineffective government regulations.

Health care reform proposals feature: 1) a more rational system of consumer cost-sharing that encourages people to economize on the use of routine health services while at the same time offering better protection for expenses associated with serious illnesses; 2) federal aid that increases with increasing need, and vice versa; 3) fixed dollar instead of open-ended federal subsidies to aid those who are unable to purchase adequate health insurance; and 4) fair competition among alternative health care plans for the consumers' dollar. In the long run, incorporating these changes into government policy will require a major overhaul of federal programs.

By reforming the system of retrospective cost reimbursement, open-ended tax subsidies, and a heavy reliance on planning and regulation characterizing current government health care policies, we might achieve an abatement in health cost increases over time without jeopardizing the quality of or access to care. But, the growth in outlays will not be reduced immediately (and could accelerate) while increased revenues may initially be minimal.

Instead of a promising set of reforms, we have seen, from both the Reagan administration and its predecessors, a continuation of budget ceilings, rate caps, and cost-shifting as the federal government strives for short-term savings.

In Medicare and Medicaid, the Reagan administration has begun to scale back Federal regulations, but thus far has offered only an agglomeration of marginal budget cuts that simply shift the cost of caring for the elderly and the indigent to patients, providers, and employers. This strategy allows the actual cost of these programs to continue to skyrocket, while chipping away the edges of those costs and changing their form. In the end, this strategy simply spells a combination of cutbacks in services to the groups in need or a shift in the cost from taxes to higher out-of-pocket health outlays and higher health insurance premiums.

To the extent that these opportunities for reform are missed or postponed continuously, efforts by the Federal government to "cap" or reduce its own involvement in these programs will only shift the difficult choices between tax increases, benefit reductions, and price controls to lower levels of government. There are numerous examples in areas such as housing, child-welfare, and health care where programs could be re-directed away from costly delivery mechanisms to more effective, efficient strategies that are also more consistent with consumer choice and the dignity of program participants.

Private sector initiatives

We are now facing a dilemma in social policy: the American people still want to pursue the basic social goals embodied in past government programs; but they are reluctant to continue paying the freight. Moreover, as people ratify, if not compel government's pursuit of other goals (e.g., returning the tax increases attributable to past "bracket creep" and enhancing our defense posture), a squeeze is placed on the government resources available for social programs, exposing this latent contradiction in public attitudes.

In part, this dilemma may be resolved as elected officials perceive the public's desire to maintain the basic governmental role in meeting human needs and ease up on budget cutting. This development, which is already unfolding, will force a choice between higher taxes and large deficits. The latter would translate into either higher interest rates or higher inflation. As argued earlier, basic reform and redesign of our government programs is a promising way to ease the tension among the public's desires. But, such reforms cannot be devised and implemented overnight. Thus, we need to pay more attention now to the potential of private sector initiatives for improving our social problems.

I do not suggest turning over to the private sector the effort to assist low-income families in meeting their basic human needs such as health care or nutrition. These basic needs for low-income people must be met primarily through government assistance. As I have indicated, we can effectuate long-term savings in government programs in these areas by fundamentally redesigning the delivery and financing mechanisms and improving the work incentive features of these programs. Moreover, I believe that meeting these basic human needs for the disadvantaged is the responsibility of the federal government. These problems are national in scope, and will not be addressed by devolving them to lower levels of government. Such a step would only transfer the difficult choices between benefit cutbacks, tax increases, and program reforms to the States, and would foster an uneven access to basic social services across geographic boundaries. While "privatization" of such vital human services is unrealistic, it would be possible to build more market-oriented incentives into our federal human service programs.

In other non-defense program areas such as community development, housing rehabilitation, education, agriculture, and transportation, I do see a growing role for more local decision-making and for private sector initiatives. We have relied too heavily on rigid, uniform federal programs in these areas that are more amenable to decentralized efforts tailored to local circumstances.

Concluding Remarks

It is worth reemphasizing that I view the increasing inability to fulfill our social contract with program beneficiaries as a major social problem in the U.S. The enormous cost of fully meeting the expanded obligations of the government to recipient groups is putting a strain on those who are paying the bill. And, the huge increase in social spending is not attributable to welfare programs, but rather primarily to program benefits available to all economic groups. Indeed, many of the benefits under such social programs are indexed for inflation while most workers do not have cost-of-living escalator clauses.[19] Moreover, many of the benefits are tax-exempt while earnings from work are subject to income and payroll taxes.

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[19] About 6 of 10 workers in major union contracts (1000 or more workers) are covered by escalators, but outside of this sector--which is only about one-tenth of the U.S. work force--escalators are unusual. Moreover, escalator clauses in the collective bargaining contracts typically do not match the full increase in the Consumer Price Index. The average "yield" or recovery was 58 percent of the Consumer Price Index in 1980. (Source: U.S. Department of Labor, Bureau of Labor Statistics).

The typical worker in the private sector of the U.S. economy has experienced a decline in real income in recent years as higher taxes and accelerating inflation eroded the purchasing power of employee compensation. Many program beneficiaries are insulated from this decline in real income by the indexation and tax-exempt status of their benefits. And, some of these beneficiaries are not impoverished by any means. The "social contract" referred to earlier covers not only the poor, but also groups such as auto and steel workers receiving Trade Adjustment Assistance while waiting to return to their prior jobs. This program--originally designed to relocate workers from dying industries to more vibrant ones--became largely an income maintenance program for middle class manufacturing workers. The cost of TAA soared from $34 million in FY 1976 to billions of dollars in FY 1981. This is not to argue that social programs serving non-poor individuals lack justification entirely, but rather to observe that the process of raising the protective umbrella to cover more groups has led to a situation where some who are less needy are being protected--often in a tax-free, inflation-proof fashion--by others who are more needy and more vulnerable to both higher inflation and higher taxes.

This disparity between the experience of those who are assisted and those who are assisting has both diminished the willingness of workers to continue financing these programs and damaged the incentive to trade a status of dependency for work among benefit recipients who are able to work. Indeed, the adverse work incentives associated with some of the overlapping benefit programs have probably increased unemployment. If ways are not found to ease the strain on the working population who must support both the non-aged in a dependent status and the steadily-swelling number of aged people, the result could be growing class and intergenerational conflicts in U.S. society.

In part, these conflicts could be eased by a relaxation or postponement of the commitments to increase our defense capability or to reduce inflation. A retreat from these objectives, of course, would bring other problems and conflicts to the foreground. I will let the reader decide how much emphasis or priority to give these different objectives. My main point is that they cannot all be achieved simultaneously in a brief period of time, and the resultant tradeoffs must be soberly addressed. These tradeoffs can be reduced, however, to the extent that we are willing to 1) remove the non-needy from income maintenance programs; 2) improve the work incentive features of social programs; 3) tighten up claims review, returning programs to their original intent; 4) redesign programs with uncontrollable cost increases; and 5) rely to a greater extent on the resources of the private sector to meet our social needs.

CONSTRAIN PROGRAM GROWTH

Senator **Boschwitz**. Dr. Meyer, you certainly have made a very clear statement of the problem.

Let me ask you to be somewhat more specific with respect to some of the programs that, as you point out, have grown very rapidly and probably some of that growth will have to be abated. Give me some specific way in which you would constrain the growth of programs such as, social security, and if you will, inject some comments about the political realism about each one of your suggestions

Dr. **Meyer**. I would be glad to.

Of course, the latter makes any cost-saving measure more difficult to accomplish

Senator **Boschwitz**. Do not feel restricted in making comments about the improbability of the political outcome.

RETIREMENT PROGRAMS

Dr. **Meyer**. I think with regard to retirement programs, first of all, we should phase out the earnings test that prohibits workers in the 65 to 72 age category from keeping a significant share of their earnings after $6,000. I think that even more important, in the short term, would be a measure to provide less than full indexation of benefits. When you consider that over the past decade social security benefits have outpaced the earnings of workers, so that in effect benefits have run ahead of wages, consideration of some smaller inflation adjustment for benefits seems reasonable. I would like to propose considering an escalation adjustment equal to 60 percent of the change in the CPI. This would put beneficiaries on a par, in one sense, with workers under major collective bargaining agreements. On average, such workers receive about 60 percent of the Consumer Price Index as an escalater adjustment under their labor contracts.

So in one sense this would help restore the imbalance between recipients of social security and the average worker. It is true that some of those workers have received fixed wage increases as well, but I think this plan should still be considered because social security recipients also have some outside income.

With respect to Federal workers, whose situation I went over in my testimony, it seems to me that we should consider a major reform in the professional, administrative, technical, and clerical survey to make it more representative, and to include employee benefits which are now excluded. Right now if you follow comparability under Federal pay, you would be overcompensating Federal workers because employee benefits are not included in the comparisons, and studies by CBO and other groups show that the package of Federal benefits, particularly due to the pension situation I highlighted, is much richer. So I would include those reforms for Federal workers.

MEDICARE AND MEDICAID

With respect to medicare and medicaid, it seems to me that we need to consider redesigning benefits. Again this will be tough political sledding in the case of medicare, but consider now we have a program that collects money at the "back end," when beneficiaries are the sickest. That is when we have cost sharing. After the 60th day of hospitalization you take on cost sharing whereas after the 1st day, there is no cost sharing for medicare people between the 2d and the 59th day.

I would like to see a little more contribution by the medicare recipient at the front end for routine services and combine that with a stop loss or catastrophic feature in medicare.

I would also like to see medicare opened up to alternative benefit plans. Only 1 percent of medicare enrollees use HMO's. I am not pushing HMO's but if we can make a capitation payment on behalf of the medicare recipient to be used either for the standard medicare package or taken outside the package to the private insurance system, we might achieve some cost savings in the end. That would not occur overnight. What concerns me is that I see current policy groping for short-term savings and sacrificing the long-term reforms to that end.

Let me give you a quick example. In the health care area, when you examine the proposals in the 1983 Reagan budget, you see cost cutting measures like making a medicare applicant wait until the first of the month to become eligible or a 2-percent cut in Government reimbursement to hospitals.

Does anyone think that because the Federal Government pays hospitals 2 percent less, their costs will be 2 percent less? Of course not. These are band-aids to get us through the current crisis, and I understand the current crisis, but what I am suggesting is we take a longer view and look at those out-years. That is what frightens me about CBO's estimate of the deficits on the order of $200 billion to $250 billion in the mid to late 1980's. That worries me more than what to do with the current deficit.

ELIMINATE BENEFITS FOR WORKING PEOPLE 65 AND OVER

Senator **Boschwitz**. Let me ask one more question.

In removing restrictions on earning requirements, phasing out of the earnings test would actually cost money in the short term. As you point out, we have to look at things from a longer picture as well. But we also have shortrun considerations because of that large deficit.

In just a very brief answer, what would you think of just not allowing people 65 and over to receive social security in the event that they are working or if they do not receive social security, that they should receive incentives, perhaps three-quarters of a percent per month so that they will be inclined to continue to work and perhaps by the time they are 70, collect 135 or 140 percent of their social security? Do you think that is a viable idea?

Dr. **Meyer**. Well, Senator, in my view it would be foolish to take all the benefits away from a social security recipient when he or she begins to work in their late sixties or early seventies. Just as I think it is tempting but foolish to take the AFDC mothers' earnings away. There is a tendency to say, and I understand this, well, now you have a job, you do not need help from the Federal Government. But you have to consider it from the vantage point of the person considering each month or each quarter whether to continue working. If there is 100 percent tax rate on earnings—if they are in effect no better off working than not working, they may decide not to work. I think, of course, in the short run, this would cost some money but I think it would be a good investment, not only, I might add, for the longrun viability of the U.S. Treasury, but also for the vitality and the well-being of our senior citizens who, in many cases, want to work, and that is also true of the working poor.

TAX SOCIAL SECURITY

Senator **Boschwitz**. What do you think if the retiree has outside income, in excess of $20,000? What would your thought be about taxing social security?

Mr. **Meyer**. Well, I think we have to give some thought to that, $20,000 may be too low to start with. One idea I had, and I think others have considered this, is to start with some kind of a ceiling, like $50,000, above which you would reduce benefits somewhat. I have mixed feelings about that because these people have contributed to this system all their lives and it is difficult not to give them their full benefits, even if they happen to be well off. I am reluctant to go to a means test in a program like social security. But if it were necessary, I would support a trial of that, starting at a higher ceiling and then working it down, if we had to.

CHANGE SOCIAL SECURITY ELIGIBILITY

Senator **Boschwitz**. Final short question.

Of course, one works 31 quarters and obtains social security. Yet, somebody who has worked a lifetime and has not been in a public sector really does not gain much advantage over somebody who works for a relatively short period of time.

What do you think about expandinq that 30 quarters, let us say, to 80 quarters, changing the eligibility?

Dr. **Meyer**. I think that is an idea with merit. Again I would propose starting with a less drastic increase, and one area you might want to start with is Federal workers where many Federal workers are receiving a very, very rich set of retirement benefits and, in addition, because they have several quarters in the private work force, getting their social security as well. So this might be a group to start with along those lines.

Senator **Boschwitz**. You would, of course, exclude members of the Senate?

Dr. **Meyer**. Of course.

Senator **Boschwitz**. Senator Johnston.

SOUNDNESS OF SOCIAL SECURITY FUND

Senator **Johnston**. Dr. Meyer, is the social security fund sound, actuarially sound at this point?

Dr. **Meyer**. Well, I suppose at this point it is, in the sense that it is not in the red at the immediate present time. I am not an actuary and I do not have detailed knowledge about this. But my understanding is that in the very near future it will be in serious trouble, so that in the sense of the long-term relation between obligations and resources, the funds are not sound. Certainly what concerns me even more is looking out 20 or 30 years under the current benefit structure. There just simply will not be enough, except at an extremely high payroll tax, for people in my age cohort, 20 years from now. You only have to look at the out-years and you start to worry.

Senator **Johnston**. I quite agree, it is not sound on the long term. My question is what would be wrong with saying we are going to take that fund with the present tax structure and insist that it be operated in an actuarially sound system? If we did that, what kind of benefits, what kind of increases could we pay? Rather than the CPI, what could we pay if we did it on that base?

Dr. **Meyer**. Well, I would think that one would not have to eliminate escalators, in order to put the OASI fund on sound footing. I have not done thorough research on this. Others know it better than I. But my view is that if you used a factor of about 60 percent of CPI combined with some of the other reforms, that it would do the job, at least through the 1980's. A 60-percent plan alone could eliminate about 90 percent of the projected OASI shortfall in mid-1980. I am convinced that we would not have to allow the benefits of recipients to fully erode by giving them no escalation. I think this partial adjustment, combined with outright reforms to address the longrun problem, would do it.

BALANCED BUDGET UNREALISTIC WITHOUT DEALING WITH ENTITLEMENTS

Senator **Johnston**. Dr. Meyer, is it realistic to expect that this President or any other President could ever balance the budget without dealing with the question of entitlements?

Dr. **Meyer**. No, I do not think he could, and, frankly, I might add that I think it is not realistic for this President or any President to balance the budget unless none of the major items is treated as sacrosanct. We have to open up the entire budget for full scale review and careful elimination of waste, and that includes the defense area, that includes social security, that includes medicare. We cannot just operate on the decreasing share going to low-income people and think that we can balance the budget.

Senator **Johnston**. That also includes the tax programs?

Dr. **Meyer**. Yes, I think it does. Obviously the more that you do by taking on the full panoply of Federal programs, the less you have to go back on proposed tax cuts. I would hope frankly, Senator, that we could preserve the principle of indexation, which I think is a good one for honesty in Government in the long run. But in 1982 and 1983, we might have to consider a package of some changes in taxes and a full-scale review of the entire fiscal year 1983 budget.

Senator **Johnston**. Thank you, Mr. Chairman.

Senator **Boschwitz**. Senator Symms.

Senator **Symms**. Thank you very much, Mr. Chairman.

Dr. Meyer, I read about a week or two ago in U.S. News & World Report where the social security program pays out $12,800 a minute more than it takes in in revenue. As you know, it operates on the principle of a chain letter which would be illegal in the private sector, but it has been legalized through Government for their own chain letter operation.

But I hold this chart up to show you the growth in civil service and retirement benefits from 1970 to the present where social security payments have gone up 205 percent on a baseline, cost-of-living CPI has gone up 149 percent, and the average weekly earnings of the American working man and woman have gone up 129 percent.

Do you think that the Congress can not adjust that and fix it and be equitable to the people that are paying for it? How do we ignore that without everybody under 50 starting to resent everybody that is over 65?

Dr. **Meyer**. I think you cannot ignore it, Senator. What I am saying is that each group comes forward, I know, and says you cannot touch our benefits and gives you a very good reason why it would be inequitable to do so. But the problem is, as you point out, the combined or cumulative effect of giving in to each one of those is felt very subtly by the American worker as his wages suddenly get out of line with or even fall behind the people whom he or she is supporting.

INDEXING HAS BEEN OVERDONE

Senator **Symms**. But if you projected the CPI line right across, I would venture to say social security would not be in any financial difficulty. The chain letter would be doing fine. What we have done is the indexing has been overdone.

Dr. **Meyer**. That is right. That started in 1972 with the changes made then which I understand contained errors in calculations which were subsequently corrected in 1977, but that resulted in a great deal of overpayment in that period. But looking at the seventies as a whole, the real benefits—the ratio of benefits to earnings, the benefits of recipients to earnings of workers have gone up about 50 percent. So while the American worker has just stayed even on average with inflation over the decade of the seventies, the recipient has gone ahead 50 percent. Therefore, that recipient has gone ahead of the worker.

Senator **Symms**. That is my point, and when we look at this budget that is so far out of balance, the Congress will not take on the so-called uncontrollables, including these retirement programs, then there is no hope to balance the budget at that point, is there?

Dr. **Meyer**. No, and what worries me is there is so much rhetoric about welfare costs and welfare cheats and fraud and abuse, and I am not in favor of fraud and abuse and so on. But what I am saying to you is there is not enough there. If you eliminated all the fraud in the welfare checks, you would not begin to address the kind of numbers we are talking about. So I suggest we get out of this rhetoric and look at all of the programs, and not just the ones that offend some people.

HIGH INTEREST RATES

Senator **Symms**. With respect to high interest rates, I wonder how it helps a grandfather who has his house paid for and his car paid for, to get an increase in his social security check, and he has money in the bank, in savings, when his grandson or even his son or daughter is not able to get a mortgage to buy a home to get out of an apartment into a house because of the high interest rates which have been brought about as a result of Congress failing to get hold of this uncontrollable expenditure.

Dr. **Meyer**. I think that is right, and what concerns me, although I am not an interest rate forecaster, but we might see a short-term drop in interest rates as the recession moves on, and I hope that does not lull us into thinking we do not have a long-term problem. The projections now for the mideighties are frightening. Not only the people you mentioned but all age groups as well.

Senator **Symms**. Thank you very much.

Senator **Boschwitz**. Senator Exon?

PERCENTAGE OF PRIVATE PENSIONS INDEXED FOR INFLATION

Senator **Exon**. Thank you, Mr. Chairman.

Dr. Meyer, I welcome you here. I was very much interested in your testimony. I think it was very much on point.

I am going to get into questions regarding some other types of retirement and I do not know whether you can be of much help to me or not because I do not know your background and expertise.

But just to start out with, what percentage of private pensions are indexed for inflation?

Dr. **Meyer**. A very small percentage, Senator. I would guess from studies I have seen, only about 5 percent. Now, it is common in some private pensions to have annual reviews and partial adjustments of a fixed nature, but as far as indexing in private company pensions and plans, it is quite rare.

Senator **Exon**. How did that get started in the Federal Government, do you know?

Dr. **Meyer**. Well, my understanding was that in the early seventies, particlarly 1972, Congress made a number of changes. I would guess it had to do with the acceleration of inflation and the fear that some recipients would fall behind. After all, most of the recipients of entitlements, although not all, are people that are in the lower half of the income distribution. I imagine that future inflation was underestimated. It was a well-intentioned reasonable attempt, and then with the roaring inflation of the seventies, it swallowed us.

Senator **Exon**. My point is, and I am not sure it is thoroughly understood in the Nation, but I do not see how we can go ahead with our programs here, however well-intentioned, and how meritorious they might be in some areas, when basically the people that are paying the wages, from which is deducted their social security and their income taxes are out there working in nongovernment agencies where their private pension funds are not indexed. It might be to—that was the reason for the question. I understood that there were very few people out there in the private sector that had never worked for the Government that were indexed with regard to their pensions.

REEVALUATING ENTITLEMENTS REQUIRES PRESIDENTIAL LEADERSHIP

Now, another question. You pointed out somewhat in your opening statement—and I think Senator Symms followed up on it in some of the questions he asked you—I suspect though when we talk about getting a hold on the difficulties we are presently having with entitlements, that it is not only the responsibility of the Congress, but would you think the President shares some responsibility also?

Dr. **Meyer**. Absolutely. In fact, I think the President needs to take the lead in this regard and to systematically scan the full range of his agencies and program areas for cost savings and to reevaluate all of the commitments. I think it requires Presidential leadership.

I might also add, Senator, that it is not only the indexation feature that requires review but also the tax-exempt feature. While the American worker is not keeping up with inflation, he is also paying taxes on his earnings while many of the pension beneficiaries are fully indexed for inflation and get tax-exempt benefits, and I think this causes an inequity. It is dispiriting to the American worker. It almost makes him wonder why he is not one of those recipients.

UNFUNDED LIABILITY OF FEDERAL PENSIONS

Senator **Exon**. Just two more questions, Mr. Chairman, that I would like to get some clarification on, if I might.

We hear a great deal today about the insolvency of the social security system. The facts of the matter are that of the types of pensions that the Federal Government is involved in, the social security system is indeed the most solvent of all. I am advised, as a member of the Armed Services Committee, that right now, today, we have unfunded liability of about $435 billion with regard to military retirement alone.

Have you done any studies in that area?

Dr. **Meyer**. Well, my understanding of work that has been done is that combined, the nine Federal pension funds that we have, including the civil service retirement and the military and others, have an unfunded liability now of about $900 billion, and that the figure for the civil service retirement system is roughly comparable, according to Congressman Erlenborn's estimates, to the one you mentioned; namely, in the range of $450 billion. It is a little bit higher than the liability under military retirement. These are changing all the time, of course.

Senator **Exon**. And, of course, the reason for this—just for the record—the reason for this is that at least with regard to social security—good, bad, indifferent, broke, wealthy, in between—we have set up a system where the employee, during his paying years, paid in so much and his employer paid in so much. So whatever you call it today, at least—would you agree with me that compared with our—the other Federal retirement systems, that comparatively speaking, the social security system is in much better shape, the best shape of all?

Dr. **Meyer**. Yes. That is sad but true. That is not saying much but I think that you are right.

Senator **Exon**. I am trying to direct some attention on some other problems.

Dr. **Meyer**. I agree with you, and I tried to highlight this in my testimony as well. One of the reasons is the high proportion of Federal workers in this country who retire at 55 years of age and get full benefits. This 30 and out that has been involved in Federal programs is going to bleed us. What concerns me more is there is a tendency to make what I call the New York City mistake, under which for years New York City management, trying to hold down wage increases, loaded unfunded obligations into their pensions system. These become problems for future mayors and Governors to work on, and then finally the debt comes due. It is nice to be able to say we only gave a 5-percent wage contract, but if we were irresponsible when loading up the other employee benefits with more than we could afford, we will pay for it later. And it worries me that the Federal Government will go down that path.

INFLATION-ADJUSTED BENEFITS RESPONSIBLE FOR LARGER PENSIONS

Senator **Exon**. I am concerned—this is the last question—and I do not know whether you have studied it or not. If you have, please enlighten us.

Those of us in the Congress are under civil service retirement system. It has recently been brought to my attention that some people who have, indeed, retired from the Congress are making more money than those of us who are still here serving. How did that come about? Because, as I understand, in most private pension systems, even the military, you retire at half or some percentage of your total income. How did we ever get to the place when Members of Congress took care of themselves so well in the past that they make more money after they retire than if they were here working?

Dr. **Meyer**. Well, I think what happens is this, and I am speaking now generally about Federal employees. I do not have all the details for retired Congressmen and Senators, but you may retire with partial benefits. But the generous indexing, the twice a year adjustments, fully indexed to the CPI, which were prevelant until Congress changed that to once a year last year, were escalating those benefits so rapidly that a person who retired 5 to 10 years ago at some proportion of his final salary then had an enormous swelling of the benefits as inflation roared in the late seventies. This actually reached the point where, within a few years, those inflation-adjusted benefits were greater than the prior salary. The Reagan administration has a proposal in its fiscal year 1983 budget addressing precisely this point, to help bring those two into balance. I would hope they would go beyond that and tackle the entire benefit structure and the Federal pay survey itself because I think the whole system is in need of reform. But they have made a step.

Senator **Exon**. What year did we go into the twice a year cost-of-living adjustment? Was it 1974 or 1975?

Dr. **Meyer**. I think it was 1972 but I am not certain about that. But Congress did change that to once a year last year. I am afraid that would not be going far enough, although that was a prudent step.

Senator **Exon**. Thank you very much, Dr. Meyer.

Senator **Boschwitz**. Thank you very much, Dr. Meyer.

[Pause.]

Senator **Boschwitz**. Mr. Secretary, we are pleased to have you before the committee today. We are certainly in need of your advice and counsel. We are anxious to go forward with the balancing of the Federal budget, and the areas that come under your jurisdiction are going to be an important part of whether or not we are going to achieve that end.

Mr. Secretary, we made opening statements earlier, and we ask you to proceed with your testimony.

STATEMENT OF HON. RICHARD S. SCHWEIKER, SECRETARY, DEPARTMENT OF HEALTH AND HUMAN SERVICES

Secretary **Schweiker**. Thank you, Mr. Chairman, members of the committee. I am delighted to be here to renew old acquaintanceships and also to have a chance to present a perspective of some of the problems we face. Rather than get into a formal statement, I am going to show you a few charts and then throw it open to questions.

1981 HHS ACCOMPLISHMENTS

The first chart[1] depicts what I feel are the accomplishments of this past year in my department. We set a new national health agenda around wellness by establishing a core group at NIH with a scientific base for initiatives. We also set up a task force for medical schools, for promoting the health professions. We started a public education program, working with such groups as the American Red Cross on hypertension, the March of Dimes on the healthy mothers and children program, and the American Advertising Council.

FDA has a new sodium label which made the cover of one of the news magazines and, in addition, we are working with the private sector to encourage participation with them in an active way.

We have a series of proposals in the consumer choice and competition area. Basically, we are dealing with hospital costs that have gone up some 19 percent this year that we find unacceptable. That is twice the rate of inflation of last year; and in the first part of this year, three to four times the rate of inflation.

We have put a priority on NIH research which is one of the areas of categorical funding that has increased slightly.

In the deregulation area, we have implemented the block grants enacted in the 1981 reconciliation bill, in which this committee played a very key role. Some 25 programs were consolidated into seven block grants to States. We also are phasing out health planning. We started a task force to close the drug lag.

In addition, we expedited some procedures and have approved some 27 new chemical entities. That is the highest amount since the Kefauver bill was passed in 1962.

In the area of welfare, we have taken steps to crackdown on waste, fraud, and abuse of tax dollars, such as stopping payments to black lung and social security recipients who are deceased, and we expect to save approximately $2 billion in this area in 1981.

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[1] See p. 159.

We did transfer Public Health Service hospitals to private use. I am rather proud of the fact that although seven administrations tried to close the hospitals, we were the first to do so. We spun them out in seven communities such as Baltimore, Seattle, Staten Island, and New Orleans, the State has established a childrens hospital. We kept the vital elements in the private sectors so that now we have 5,000 people that are no longer on the Federal Government employment rolls. We have targeted welfare benefits. We have reduced the size and cost of my department: HHS employment has been reduced by 7 percent and travel by 20 percent.

SUMMARY OF HHS FISCAL YEAR 1983 BUDGET

The next chart[1] shows my budget; that is, $274 billion. It is the third largest budget in the world. Only the Soviet Union and the United States spend more money than we do. This budget lets me spend three-quarters of a billion dollars every day. In addition, we are spending more than all of the 50 States combined.

This chart displays the HHS budget by operating division: the Public Health Service, the Offices of Human Development Services and Community Services, the Health Care Financing Administration, which primarily encompasses medicare and medicaid, and the Social Security Administration. SSA and HCFA, of course, are the biggest part of my budget.

Ninety-five percent of my budget is entitlements. So as you can see, when you try to wrestle with a $274 billion budget, if you are not willing to deal with the entitlements programs, you cannot do much in balancing the budget. These programs are categorical; the Public Health Service, the Offices of Human Development Services and Community Services, and departmental management.

The next chart,[2] Mr. Chairman, displays the HHS budget by function, to be helpful to this committee, because I know this committee deals in functions. The same array of spending has been just refigured so that you can see the functional breakdown.

As you can see, the health function gets $76 billion of that budget; the income security function, $193 billion; and the education, training, and social services function, about $5 billion.

HHS PERCENTAGE OF FEDERAL BUDGET

One of the things that I would like to mention is that in spite of some perceptions that we are drastically cutting down our social spending, just the opposite is true. The bar graphs[3] represent the total Federal budget and my budget. As you can see, the HHS budget has received a steadily rising increase in the proportionate share of the whole Federal budget.

Back in 1960, when I was a freshman in Congress; we were only spending 16 percent of the budget in my department. Today, we are up to about 35 percent of the budget and will go up another percentage point with the 1983 President's budget. Even though defense increases, we increase, too, and we will get 36 percent of the budget. My department's budget is projected to go up every year of this administration, even with the so-called reductions, which are really reductions in growth, not reductions in absolute spending.

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[1] See p. 160.
[2] See p. 161.
[3] See p. 161.

I think that important point needs to be said because my budget is actually up some $20 billion in 1983, an 8 percent increase.

GROWTH OF HHS PROGRAMS, 1950-84

The next chart[1] shows rather dramatically that the Federal budget is out of balance and where this situation originated. While this budget happens to be a chart of my department, it could well be a picture of the total government-wide social welfare spending. Back in the 1950's there was a very gradual increase in growth. It started out at just a couple of billion back in 1950, and then during the decade of the 1950's, the spending in my department went up $12.5 billion. In the 1960's, the Great Society, New Frontier days, the spending in my department went up $35 billion. For the next decade, the 1970's, it went up an astounding $145 billion, and you can see the curve taking off like a jet rocket. But the tragedy is if we do not change current law, the curve will go up further during the Reagan administration. This is hard to comprehend because of the mandated entitlements for which we are obligated to pay increasing costs due to indexing.

So the portion of the chart, which shows HHS spending as proposed is under our administration, will turn slightly upward still, which is just a little bit hard to believe, but true.

IMPACT OF ENTITLEMENT REFORMS ON HHS 1983 BUDGET, 1980-84

Senator **BOSCHWITZ**. Mr. Secretary, before you take the chart away, the chart is rather tantalizing. Are you going to suggest ways to change current law?

Secretary **SCHWEIKER**. That is my next chart.[2]

We propose a $6.8 billion change in entitlements in this budget, and I might add that even with this $6.8 billion in savings, my budget increases by $20 billion. So if I had not taken out the $6.8 billion, my budget would be up $27 billion. So my budget is up $20 billion, even though we are proposing cuts of $6.8 billion and they are all in entitlements.

One of the problems here—and this is what you have to understand—these numbers are so large that even though you are talking about a $6.8 billion adjustment, when you look at the base, it is very small.

The reason I have this next chart is to show that. If we left current law in place, then the chart for 1982-83 would grow at the rate indicated by that straight line. By changing it $6.8 billion, we change the curve downward but only slightly, and it is important to understand that $6.8 billion is a rather small amount when you look at a $274 billion base. That is why it is so important and how dramatically out of control the budget is.

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[1] See p. 162.

[2] See p. 163.

AFDC CUT SMALL COMPARED TO WHOLE BASE

Senator **Chiles**. You are showing the whole base, including social security when you are not proposing to cut that this year. Do you have a chart to show how much you are changing AFDC and what the base of that is? You are lumping it all together. It is hard for me to understand what a curve looks like to AFDC.

Secretary **Schweiker**. We can get you a chart on any segment. There is no question that there are high growth segments and low growth segments. Medicare and social security are the higher growth areas and the other areas are slower growth. AFDC would show a slower growth.

Senator **Chiles**. You make the statement that this cut is very little compared to the base. When you use the whole base, that is correct; I could understand it better if you show me how much of the base of AFDC you are cutting.

Secretary **Schweiker**. I have 300 programs in my Department. I can have a chart on any one of them. I am just picking out the big ones because, frankly, if we do not control these——

Senator **Chiles**. The biggies you are not touching.

Secretary **Schweiker**. We made a very strenuous effort to control the biggies and I was right in the forefront of that effort.

Senator **Hollings**. How did you make that effort in this year's budget?

Secretary **Schweiker**. We have a commission that is making an effort.

Senator **Hollings**. That is no effort. We have got a commission——

Secretary **Schweiker**. We are proposing $6.8 billion in entitlements savings and I think it is important to mention that.

Senator **Hollings**. That is what I am trying to get at. You and I have sat at the same table working on these budgets at the Appropriations Committee, and they are continually on the rise.

As I understand the administration's proposal on entitlements, it is simply one of keeping people from coming in.

On the others where you can control expenditures, that is your retirement and mine, no effort is being made to reduce cost and restore financial solvency. You have one fund where tha last check goes out sometime late next year; namely, social security. What does the administration recommend on that? I am impressed with the rhetoric and I am agreeing with your position, but I do not see the followthrough and that chart does not help me.

You say you have not touched it or you will——

Secretary **Schweiker**. Well, as I finish my charts, I can.

Senator **Hollings**. Will you touch it?

Secretary **Schweiker**. Yes, sir, we touch everything.

Senator **Hollings**. I want to see the chart that touches social security.

GROWTH OF HHS PROGRAMS IN CONSTANT DOLLARS, 1950–83

Secretary **SCHWEIKER**. Because some of the questions are that the figures are obviously skewed by inflation, the next chart[1] shows the growth of the programs in our department in constant dollars.

Although the constant dollar curve is not as steep, as the real dollar curve, it is still pretty steep. This chart is in constant dollars, based on 1972 dollars. In the decade of the fifties, the programs went up $17 billion. In the sixties, they went up $33 billion, and in the seventies they went up $55 billion. So if we eliminate inflation as a factor, we still have a significant rise in our programs.

DECLINING GROWTH RATE IN THE HHS BUDGET[2]

Now, I have given you all the bad news. Let me give you some good news, and that is, we are making some progress. It is important to note that the rate that these programs grow has been changed. When I became Secretary of the Department in January, I was hounded with a rate of growth that was about 17.8 percent. My budget was about $230 billion then and if it went up 20 percent, you do not have difficulty in figuring out that this is a pretty big dollar increase.

When I came into the job, it was an 18-percent growth rate and because of reconciliation—and this committee played a very big role in this—we really began to get that in harness. In 1982 because of reconciliation and the current continuing resolution—we have knocked the growth rate in my department down to 10 percent, which is beginning to be manageable, compared to about 18 percent. So the impact of reconciliation, and the impact of the continuing resolution, clearly put the trend in terms of growth rates, on the decline. The HHS budget is still going up 10 percent in 1982, which is a pretty healthy increase, but compared to 17.8 percent, it is a significant decline.

The budget for 1983 proposes $6.8 billion of entitlement cuts and also proposes an 8-percent growth rate, as opposed to a 10-percent growth rate.

HHS DISCRETIONARY AND ENTITLEMENT PROGRAMS

Now, here is an illustration of the entitlement programs[3] and the role they play in my department. Going back in the early 1970's, entitlements were about 92 percent of the total HHS budget. Now, it has gone up to 95 percent of the budget. Obviously, it went up a little faster because we cut discretionary programs. I think it is important to say one thing—because we have done better cutting the discretionary programs, things are somewhat out of balance. Discretionary programs are taking a little more because we have not dealt as concisely and directly with the entitlements program.

Senator **HOLLINGS**. Can I quote you on that?

Secretary **SCHWEIKER**. Sure.

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[1] See p. 164.

[2] See p. 164.

[3] See p. 165.

Senator **Hollings**. Thank you. You are great. That is what we have been trying to say. Discretionary programs have taken away more than their share of lumps in contrast to the entitlement programs.

Secretary **Schweiker**. It is because of the infrastructure and mechanism, as you know, in legislative procedures. Since entitlement changes require changes in law, it gets very difficult. So the discretionary programs have taken some hard cuts and the impact has not been as difficult on the entitlement programs.

GOOD OPPORTUNITY TO CONTROL THE UNCONTROLLABLES

Senator **Hollings**. Yet the nondiscretionary, or the uncontrollables continue to grow. I have never seen in Government a better opportunity to control the uncontrollables than the atmosphere and the mood of the people at this particular point.

You have organized labor freezing their benefits or actually taking cuts in benefits. You have every mayor up here that is cutting his budget back in city hall, and every State Governor freezing his budget. Everybody is doing it except us. They are waiting on us.

As you indicated in your testimony, we ought to start moving to take advantage of this opportunity to control the uncontrollable, to do something about social security and civil service retirement and these huge unfunded liabilities.

What do we recommend?

How can you and I get together and take advantage of this opportunity and really give a signal to the market that we are finally controlling the Government here in Washington and that we will get the deficit down?

Secretary **Schweiker**. Well, I think there is no question, Senator, that the signal we have got to send involves changes in entitlement programs. I think they will never believe us until we do something with entitlement programs.

Senator **Hollings**. I agree, and I agree with the statement.

Senator **Boschwitz**. What do you suggest we do, Mr. Secretary?

Secretary **Schweiker**. Basically two things.

We have made some very meaningful suggestions in the medicare-medicaid area; 1983 savings proposed in this area total $5.2 billion of the $6.8 billion in entitlement reforms. That is extremely critical, because that is where your fastest growth is occuring. By the same token, we also hope that the Social Security Commission will have some proposals we can act on later this year. Unless we deal with that, we will not be facing up to it.

That ends my presentation and I would be glad to turn to the committee.

Senator **Boschwitz**. Thank you, Mr. Secretary.

PREPARED STATEMENT OF HON. RICHARD S. SCHWEIKER, SECRETARY, DEPARTMENT OF HEALTH AND HUMAN SERVICES

Mr. Chairman and Members of the Committee:

It is a pleasure to appear before you today to discuss the President's budget proposals for 1983 for the Department of Health and Human Services.

This budget for 1983 totals $268.4 billion in budget authority and $274.2 billion in outlays, increases of $16 billion and $20.3 billion respectively above 1982.

The fiscal year 1983 budget and legislative program for this Department reflects the President's continued commitment to reducing the size, cost and burden of the Federal government, while maintaining the resources necessary to carry out our unique national responsibilities. This budget builds upon and extends the President's Program for Economic Recovery enacted over the past year.

Last year, this Administration and the Congress took a major step toward Federal spending control with the passage of the Budget Reconciliation Act of 1981. This could not have been accomplished without the cooperation of this Committee. This year, the Administration in presenting its 1983 budget is continuing the effort begun last year to reverse the trend of rapid, unsustainable expansion of Federal spending experienced in the past decade.

The key features of this budget, designed to achieve these objectives, are:

Reform of Entitlement Programs:

- An extensive review of the open-ended entitlement programs -- Aid to Families with Dependent Children, Supplemental Security Income, Child Support Enforcement, Medicare and Medicaid -- has resulted in proposals which will save $6.8 billion in outlays in 1983. The Old Age, Survivors and Disability Insurance programs of the Social Security Administration were excluded from this review.

- The reform proposals included in this budget are designed to:
  - eliminate overlapping benefits, inconsistencies and inequities in the Aid to Families with Dependent Children program to assure that benefits are available to those most in need, and to create new work opportunities for recipients;
  - modify the Supplemental Security Income program to insure that benefits are more closely related to an individual's actual income and circumstances, and to simplify program administration;
  - restructure the Child Support Enforcement program to promote more cost-effective administration; and
  - limit unconstrained growth in health care costs principally by targeting Medicaid resources to those most in need and reforming coverage policy and provider reimbursement standards in Medicare.

Full provision of Social Security benefits:

- Social Security benefits are maintained at current law levels and include full cost-of-living increases projected to be 8.1 percent in 1982 and 6.5 percent in 1983.
- No legislative proposals dealing with Social Security financing are included in this budget. The Presidentially established National Commission on Social Security Reform is charged with developing by December 31, 1982 a comprehensive and long-term solution to insure the fiscal soundness of the Social Security trust funds.

Expanding block grants:

- Last year, the Administration and Congress agreed to consolidate over 25 HHS categorical grant programs into 7 block grants to States. This action resulted in the return of decision-making on priorities to the States, a reduction of 300 pages of cumbersome and restrictive Federal regulations, and decreases in administrative costs.
- This year's budget represents another step in this direction and proposes to consolidate four additional programs into the Primary Health Care and Maternal and Child Health block grants and to create a new block grant for Child Welfare Services, from four existing categorical programs.
- Funding for these block grants totals $5.7 billion in 1983.

Maintenance of Federal government commitments:

o A continuing priority has been accorded to those programs which represent national commitments, or for which a Federal role is unique. These programs cannot be recreated effectively or efficiently in the States or the private sector.

o Included in this category are such programs as the biomedical and behavioral research activities of the National Institutes of Health and the Alcohol, Drug Abuse and Mental Health Administration; the preventive health efforts of the Centers for Disease Control and the Food and Drug Administration; and the services to disadvantaged children provided by the Head Start program.

o Funding for these programs is maintained or increased in this budget request.

Close scrutiny of discretionary programs:

o The 1983 budget continues the effort begun last year to reduce or eliminate programs which are less essential, or marginally effective, and those which can best be supported in other ways. In 1982, Congress agreed to a portion of the Administration's proposals in this area, including the termination of HHS support of PHS hospitals and their transfer to community sponsorship or new uses, and reducing Federal funding of health planning and Professional Standards Review Organizations.

o In 1983, we have attempted to emphasize only the highest priority discretionary programs, and to reduce funding in lower priority activities and administrative support areas.

Continued emphasis on effective management:

o The Department is intensifying efforts to improve the management of HHS programs in order to control spending, to minimize waste, fraud and abuse, and to enhance stewardship responsibilities.

o The actions which have been taken or are planned include:

-- A plan has been established to begin collection in 1982 and 1983 of the nearly $3 billion in debts owed to the Department. Improving debt management and collection efforts is a high priority of this Administration.

-- Special Departmental task forces have been formed to address regulatory problems and to find ways to simplify needlessly burdensome requirements. These task forces will examine regulations which can unnecessarily burden hospitals, ways to streamline the development and review of new drugs, while maintaining essential protections, and means to simplify and consolidate reporting and other requirements on the States.

-- Audit activities have been stepped up, with special emphasis on closing out audits with monetary findings which were unresolved for more than six months, as required by law. By September 30, 1981, there were no such unresolved audits more than six months old, and the Department intends to continue to meet this standard.

-- The paperwork burden that HHS imposes on others decreased by 20.3 million hours in calendar year 1981, a reduction of 25 percent from the previous year.

-- Improving the Social Security Administration's (SSA) Automated Data Processing systems to improve service to a growing number of beneficiaries and insure prompt and accurate payment of monthly benefits is a high priority. The Department has announced a comprehensive plan for upgrading these systems.

New partnership with States and localities:

o In his State of the Union message to the Nation, President Reagan outlined a comprehensive Federalism initiative to sort out the responsibilities which should be properly assigned to each government level and return to the States those responsibilities better handled by the States.

- One of the basic features of this proposal which affects this Department is an exchange of responsibilities, whereby the Federal government would assume the cost of the Medicaid program in return for which the States would take full responsiblity for the Aid to Families with Dependent Children (AFDC) program and the Food Stamp program currently administered by the Department of Agriculture.
- Details of the Administration's proposal are being worked out in consultation with State and local officials, and the enabling legislation will be submitted to the Congress this spring.

SOCIAL SERVICES
(FUNCTION 500)

The HHS budget includes budget authority of $4.9 billion and outlays of $5.1 billion for Social Services activities.

This budget continues the effort begun in 1982 to increase State flexibility in the programming and administration of program resources and to simplify Federal administrative and oversight responsibilities.

Block Grants

In 1982, the Social and Community Services Block Grants were created in an effort to increase State flexibility in developing programs to meet their own needs and priorities and reduce Federal regulation and reporting requirements. Consistent with those goals, we are now proposing a Child Welfare Block Grant that would consolidate the Child Welfare Services, Foster Care, Adoption Assistance and Child Welfare Training programs.

For the Social Services Block Grant, the 1983 budget request is $1,974 million. This request includes authority for the States to use Social Services Block Grant funds to support ongoing Work Incentive programs and Work Incentive demonstration projects initiated in 1982.

For the Community Services Block Grant, the 1983 budget includes $100 million.

The Child Welfare Block Grant proposal is patterned after the block grant models enacted in 1981, while being sensitive to the needs of the particular population being served, as provided for in the Adoption Assistance and Child Welfare Act (P.L. 96-272). This block grant will include limited conditions to assure that important reform provisions in that act receive continued attention. The overall objectives of this program are to strengthen families, prevent family break-up, and enable children to remain in their homes. In cases where children must be placed outside the home, the objective is to return these children home as soon as possible; or, if this is not possible, to secure suitable adoptive homes. The budget request for 1983 is $380 million.

Head Start

The Head Start program, which provides comprehensive support services and early childhood development for poor children up to age 5, continues to be a priority of this Department.

The proposed 1983 budget of $912 million, the same level as 1982, will maintain Head Start services at a projected enrollment level of 377,300. Of the children served by this program, 90 percent are from poor families and 10 percent are handicapped.

Aging Programs

The 1983 budget proposes $606 million for State-operated programs which finance nutrition, transportation, in-home and legal services to persons over 60 years old. Within the total 1983 level, it is expected that the States will be able to support:

- 670 Area Agencies and 57 State Agencies.
- a full-range of community services for the aged, including information and referral, transportation and counseling. An estimated 3.2 million elderly people will be served.
- an estimated 607,845 daily meals in both congregate sites and through the home delivery program.

Rehabilitation Services and Special Institutions

Consistent with the Administration's proposals regarding the Department of Education, the HHS budget includes funds to support Rehabilitation Services programs ($637 million), the National Institute for Handicapped Research ($26 million), and Special Institutions (American Printing House for the Blind, the National Technical Institute for the Deaf, and the Gallaudet College Complex -- $83 million).

HEALTH

(FUNCTION 550)

The 1983 HHS budget includes outlays of $76.4 billion for HHS activities -- Medicare, Medicaid, and the discretionary programs administered by the Public Health Service.

Medicare/Medicaid

The 1983 request for the Health Care Financing Administration, which administers the Medicaid and Medicare programs, totals $68.1 billion in outlays, an increase of 7 percent over the current estimate for 1982. This increase is due primarily to the estimated effect in 1983 of the continuing rise in the cost of health care. Under current law, approximately 47 million beneficiaries will be served through the Medicare and Medicaid programs in 1983.

The 1983 budget provides for significant savings in the delivery of health care services through a series of entitlement reform proposals that would:

- target Medicaid expenditures to those most in need;
- reform Medicare coverage policy;
- reform provider reimbursement; and
- streamline program administration.

These cost savings efforts will hold Federal health expenditures next year to approximately $4.6 billion below what they would otherwise be.

Mr. Chairman, these proposals differ, in a sense, from proposals in other entitlement areas. In addition to the problem of rapidly expanding eligibility, health care entitlements also suffer from the explosive growth in the cost of health care services generally. In the period between 1965 (when Medicare and Medicaid were enacted) and 1980, health care costs rose at the rate of 12.6 percent annually, during a time when the inflation rate averaged only 7.7 percent.

Costs of the Medicare program in 1980 were $35 billion, a 20.2 percent increase over 1979. Medicare expenditures in 1981 were $42.5 billion, a 21.3 percent increase over 1980. In 1982, Medicare expenditures are projected to reach a staggering $49.6 billion, or a 16.6 percent increase over last year.

The funding picture with respect to Medicaid is also alarming. In 1967, the first full year of implementation, combined State and Federal costs for this program totalled $1.9 billion. By 1982, the Federal share of Medicaid payments will soar to nearly $17.8 billion.

Hospital costs have been the largest factor driving total Medicare/Medicaid program costs. And these costs have continued to rise at an intolerably high rate -- nearly a 19 percent increase in 1981 alone. Our present cost-based reimbursement system continues to contribute to this trend by paying whatever the hospital bills us, even as we are trying to reduce inflation in the economy and cut the size of Federal spending.

It is important to remember, too, that hospitals are a major recipient of Medicare and Medicaid reimbursements and they rely on this source for their continued existence.

Therefore, we believe they must be willing to share in the burden of reducing Federal expenditures in order to guarantee over the long term the financial viability of these programs.

I would like to point out here that the Medicare Hospital Insurance trustees now estimate that because of expected inflation in hospital costs, the Trust Fund will spend $67 billion under current law in 1987 -- a dramatic 175 percent increase over its 1980 disbursements. Expenditures under the hospital insurance program are of critical importance for they comprised 69 percent of all Medicare expenditures in 1981. If Medicare is to continue to meet the basic health care needs of the elderly, these trends must be checked.

Medicare Proposals

Our FY 1983 budget contains a number of proposals which would meet basic health needs yet reform Medicare coverage policy and reimbursement to providers as well as streamline program administration. Major savings resulting from these proposals will be derived primarily through those provisions affecting reimbursement of hospitals and physicians, coordination with other insurance plans, and coverage of Federal employees under Medicare. Our Medicare proposals would hold 1983 expenditures to approximately $2.5 billion below what they would otherwise be, and generate additional Federal revenue of approximately $600 million. We have carefully analyzed our proposals in order to minimize any undesirable impact on beneficiaries.

Briefly, the major proposals are:

- Bring Federal employees under Medicare Part A. Applying the Hospital Insurance tax to Federal employee wages will result in $1,238 million in additional revenue to the trust fund in fiscal year 1983, and $619 million in net deficit reduction. For the first time, Federal workers would become eligible for Medicare based on their Federal employment.

- Reimburse hospitals at 98 percent of reasonable costs. Federal savings from this proposal would equal $653 million in fiscal year 1983. This decrease of 2 percent would be an interim step pending development of a long-term solution to the very serious problem of rising hospital costs I mentioned earlier. This approach is similar to the Medicaid cost reductions adopted by the Congress in the Omnibus Budget Reconciliation Act of 1981 and has the same goal -- reducing the rapid rate of increase in Federal health care expenditures.

- Establish utilization targets to reduce unnecessary use of hospital and medical care, saving $330 million in FY 1983.

- Other Medicare proposals include modifying Medicare coverage of the working aged; reimbursing inpatient radiology services at 80 percent of reasonable charges; establishing Medicare eligibility at the beginning of the first full month after attaining age 65; indexing the Supplementary Medical Insurance deductible; and eliminating duplicate Medicare payments for services in outpatient departments.

Medicaid Proposals

We are also proposing several legislative and regulatory initiatives that emphasize control over Medicaid costs and would improve the efficiency and effectiveness of the program. As you know, we are engaged in discussions with the Governors on the details of the President's Federalism Initiative, which, if approved by Congress, will mean that the Federal government will assume financial responsibility for the Medicaid program beginning in 1984. Absent reforms in the interim, however, Medicaid costs will continue on an upward spiral.

The major proposed reforms include:

o Require cost-sharing by Medicaid recipients. We are proposing legislation which would require a $1 per visit co-payment on the categorically eligible and a $1.50 per visit co-payment on the medically needy for physician, clinic and hospital outpatient department services. Also, a $1 and $2 co-payment per day would be required of the categorically and medically needy, respectively, for inpatient hospital services. A number of States have applied for waivers of current law to allow them to institute co-payment practices. Furthermore, we believe a requirement for modest cost-sharing will make beneficiaries and their physicians more cost conscious in their use of health care services. This initiative would result in Federal savings of $329 million in 1983.

- Lower Federal matching rate for optional services for the categorically eligible and all services for the medically needy by 3 percent. This would provide States with an incentive to target resources on those most in need and on services with the highest priority. Federal savings would be $600 million in 1983.
- Eliminate the Federal matching payments for Medicare Part B "buy-in" with resulting Federal savings of $203 million in 1983.
- Other proposals include shortening the automatic extension of Medicaid eligibility, allowing States flexibility in recovery of long-term care costs; and establishing a policy of phasing out Federal reimbursement for erroneous payments.

Discretionary Health Programs

For the discretionary health programs of the Public Health Service (PHS), the 1983 budget includes outlays of $8.3 billion.

The budget continues the program priorities and health goals implemented over the past year by the Reagan Administration. Those priorities include maintaining a strong research capacity, increasing the authority and control of States over the use of Federal health funds through block grants, and preventing disease and promoting public health.

Biomedical and behavioral research is a vital component of our efforts to achieve improvements in the Nation's health. The budgets for the National Institutes of Health (NIH) and the Alcohol, Drug Abuse, and Mental Health Administration (ADAMHA), the principal sources of Federal support for research, total $4.1 billion in 1983.

The promise by this Administration to increase the authority and responsibility of States, cities, and counties has become more of a reality with the enactment of legislation to consolidate over 20 categorical health grant programs into four block grants to States. This has resulted in giving States and local governments greater control over the use of Federal resources to meet their public health needs.

To further this effort, the Administration proposes to add three programs (Black Lung Clinics, Migrant Health Centers, and Family Planning Services) to the current Primary Care block grant in 1983. Also, the Women, Infants, and Children (WIC) special supplemental food program, now administered by the Department of Agriculture, is proposed for inclusion in the existing Maternal and Child Health block grant. By converting these remaining programs to block grants, the States will have maximum flexibility to set priorities, better integrate services and delivery sites, and meet the needs of their citizens. The 1983 budget includes $1.9 billion for the block grants: $417 million for Primary Care, $82 million for Prevention, $432 million for Alcohol, Drug Abuse and Mental Health, and $1 billion for Maternal and Child Health.

The 1983 budget request for two of the principal prevention organizations of the PHS, the Food and Drug Administration and the Centers for Disease Control, is $356 million and $217 million respectively. At these levels the PHS will continue to provide such traditional and vital preventive health measures as ensuring the safety and purity of foods and the safety and effectiveness of drugs and medical devices; detecting and identifying diseases and health hazards; and developing improved methods for protecting the public health.

INCOME SECURITY

(FUNCTION 600)

The Department's income security programs for the aged, disabled and poor, managed by the Social Security Administration (SSA), will have estimated program outlays of $192.5 billion in 1983. This constitutes about 70 percent of the HHS budget. About 49 million people will receive assistance from these programs in 1983. Outlays for Income Security programs in 1983 reflect an increase of $18 billion above 1982, or 10 percent.

Social Security Benefits

Social Security trust fund outlays will increase by $15 billion in 1983. Continued growth in program costs is due largely to two factors: expanding beneficiary population (up over half a million in 1983), and higher benefit levels, principally due to cost-of-living increases (8.1 percent estimated for July 1982, and 6.5 percent estimated for July 1983).

On December 29, 1981, the President signed P.L. 97-123 which provides temporary authority until December 31, 1982 for interfund borrowing among the Old Age and Survivors Insurance (OASI), Disability Insurance (DI), and the Hospital Insurance (HI) trust funds at the discretion of the managing trustee (Secretary of the Treasury). That provision will enable financing of all benefit payments through June 1983. Without additional interfund borrowing or other Congressional action to put this system on a sound footing, it is estimated that OASI income and assets will be insufficient to cover payment of benefits when due, beginning in July 1983.

To put Social Security back on a sound financial footing and restore public confidence in the system, the National Commission on Social Security Reform will prepare and submit to the President by December 31, 1982, legislative recommendations to insure the current and long-term solvency of the Social Security Trust Funds. For purposes of display, the 1983 budget reflects a continuation of interfund borrowing among the trust funds. However, no specific legislation is being proposed with this budget pending the receipt of the recommendations of the Commission.

SSA is undertaking or continuing several program initiatives aimed at protecting the integrity of the trust funds. In the OASDI programs, a debt management initiative aimed at detecting and recovering overpayments to beneficiaries is estimated to save approximately $500 million in 1983. In the DI program, the Congressionally-mandated review of new disability awards will continue, and the review of current disability beneficiaries who are not permanently disabled will be increased.

The OASDI estimates reflect an Administration proposal to provide direct Social Security coverage for all current and future career railroad workers. The basic benefits currently paid to this group under the Railroad Retirement program (in conjunction with a financial interchange with Social Security) would become regular Social Security benefits. The supplemental pension system based on railroad service would be converted to a private industry system.

Supplemental Security Income (SSI)

The 1983 outlay estimate for the SSI program is $8.9 billion and includes a number of changes which reduce 1983 estimates by $0.3 billion. These proposed changes fall into three categories:

- relating SSI benefits more closely to an individual's income and circumstances;

- o tightening the eligibility requirements for disability benefits in the SSI program; and,
- o simplifying program administration.

Aid to Families with Dependent Children (AFDC)

The Administration is proposing a number of changes in the AFDC program, the basic Federally-assisted cash assistance program, as part of the 1983 budget. These proposals, estimated to save $1.1 billion in 1983, are intended to complement the changes adopted last year as part of the Omnibus Budget Reconcilation Act and to further ensure that assistance is provided only to those who are in need and who are not in a position to provide for themselves; that strong work requirements exist; and that administration of the program is improved.

Several of our proposals would require that, in determining a family's need for AFDC, all sources of income available to the family be considered. These proposals would end the practice whereby families exclude members with income from the assistance unit in order to maximize benefits. They would also require States to recognize the contribution of individuals who share a household with an AFDC unit. We believe that employable adults whose youngest child is 16 are sufficiently free from family responsibilities to no longer require assistance.

There are several other proposals designed to strengthen work requirements and improve the employability of recipients. The Administration believes that all able-bodied individuals who request assistance should be involved in some type of work-related activity or job search from the day they apply. Placement in private sector employment will remain the foremost goal for these individuals. We propose to require:

- that all applicants who are able to work and not caring for young children be required to begin a job search as soon as they apply for assistance; and
- that those whose search is unsuccessful and who become recipients be required to actively participate in a community work experience program, work supplementation program, or other activity designed to increase their employability through actual work experience, and in continued job search at intervals set by the State.

We also have two proposals aimed at reducing administrative inefficiency. These include the proposal to eliminate over several years Federal matching for all erroneous AFDC benefit payments and to establish a consolidated grant to combine and cover State and local costs of administering the AFDC, Medicaid, and Food Stamp programs at 95 percent of the FY 1982 level. Both of these proposals offer strong incentives for States to tighten administration of these programs.

Child Support Enforcement

The Child Support Enforcement program assists States in enforcing the support obligations of absent parents to their children, locating absent parents, establishing paternity and obtaining child support. These services are provided to AFDC families and are available upon request to families who are not recipients of public assistance in recognition of the cost avoidance or deterrent value of such services. The Federal government at present pays the great preponderance of the administrative costs of the program and provides a wide range of services and technical assistance to the States.

A major legislative initiative will be proposed to restructure the financing of the Child Support Enforcement program. While Federal funds were essential at the time of enactment of the basic authorizing legislation in 1975, the Child Support Enforcement program has now attained a degree of maturity. However, there is ample evidence to demonstrate that the cost-effectiveness and efficiency of State and local operations can and should be improved.

On a nationwide basis, there is still an untapped potential to increase child support collections. Program effectiveness varies widely from State to State. Costs are often excessive in relation to support collection. The net result is a deficit to be borne by the Federal government, under current law, of $191 million in FY 1983. Our restructuring proposals will establish a clear focus on State performance, and serve as tangible recognition of superior performance. These proposals will reduce 1983 outlays by $145 million. Even with these changes States will enjoy a favorable position of receiving in excess of $300 million in collections.

Low Income Home Energy Assistance Block Grant

For FY 1983 the Administration is proposing to spend $1.3 billion on a block grant combining the low income home energy assistance block grant with emergency assistance provided under title IV-A of the Social Security Act. The new block grant will allow for more efficient provision of emergency assistance and for coordinating this aid with energy assistance.

Reporting requirements, assurances and compliance procedures also would be reduced or eliminated, thereby providing for increased flexibility and reduced burden for the States.

Refugee and Entrant Assistance Programs

For the Refugees and Entrant Assistance Programs, $532 million in budget authority and $633 million in outlays is requested in 1983.

Special Federal funding for programs which assist refugees and entrants who have resettled in the United States is authorized by the Refugee Action of 1980 and the Refugee Education Assistance Act of 1980. In 1983, expected obligations for Refugee and Entrant programs total $532 million, down $138 million from 1982. This reduction reflects:

- a continued decline in the number of new refugees entering the United States--the 104,000 arrivals estimated for 1983 is 27,000 fewer than those expected to be admitted in 1982.

- the transfer to the Justice Department of responsibility for the care and treatment of Cuban and Haitian entrants who remain in the custody of the Immigration and Naturalization Service;

- the first full year impact of new cash and medical assistance eligibility rules scheduled for implementation during the current fiscal year; and

- phase-out of special educational assistance which augments regular elementary and secondary education programs.

That concludes my statement. I will be happy to answer any questions you may have and look forward to working with you on the 1983 budget.

Department of Health and Human Services

Fiscal Year 1983 Budget

Charts for the Secretary's Testimony before the Senate Budget Committee

March 16, 1982

Department of Health and Human Services

1981 HHS Accomplishments

I. A New National Health Agenda

- **A. Wellness**
  - **— NIH Basic Research**
  - **— PHS Task Force: Medical Schools Cooperation**
  - **— Public Education**
  - **— Sodium Labelling**
  - **— Private Sector Programs Being Encouraged**
- **B. Consumer Choice and Competition Proposals**
  - **— Task Force Options Look to Positive Incentives including:**
    - **Offer a Range of Choices to Employees**
    - **Vouchers for Medicare Choices**
    - **Medicare Cost Sharing and Catastrophic Coverage**
- **C. Preserved Vital Research at NIH**

Department of Health and Human Services

1981 HHS Accomplishments (Continued)

II. Deregulation
  A. Block Grants to States
  B. Phase out Federal Health Planning Role
  C. Started Closing the "Drug Lag"

III. Crackdown on Waste, Fraud and Abuse of Tax Dollars

IV. Transferred PHS Hospitals to New Uses

V. Targeted Welfare Benefits

VI. Reduced Size and Cost of Federal Bureaucracy
  – Cut HHS Employment by 7% or 10,860
  – HHS Travel Expenses Cut by 20%

Department of Health and Human Services

Summary of FY 1983 Budget

	(Dollars in Millions)	
	Budget Authority	Outlays
Public Health Service	$ 7,782	$ 8,303
Health Care Financing Administration	67,990	68,052
Social Security Administration	187,464	192,524
Offices of Human Development Services and Community Services	4,931	5,046
Departmental Management/Other	244	240
Total, HHS	$268,411	$274,165

- FY 1983 HHS budget includes increases of $20.3 billion in outlays (8%) compared to 1982.

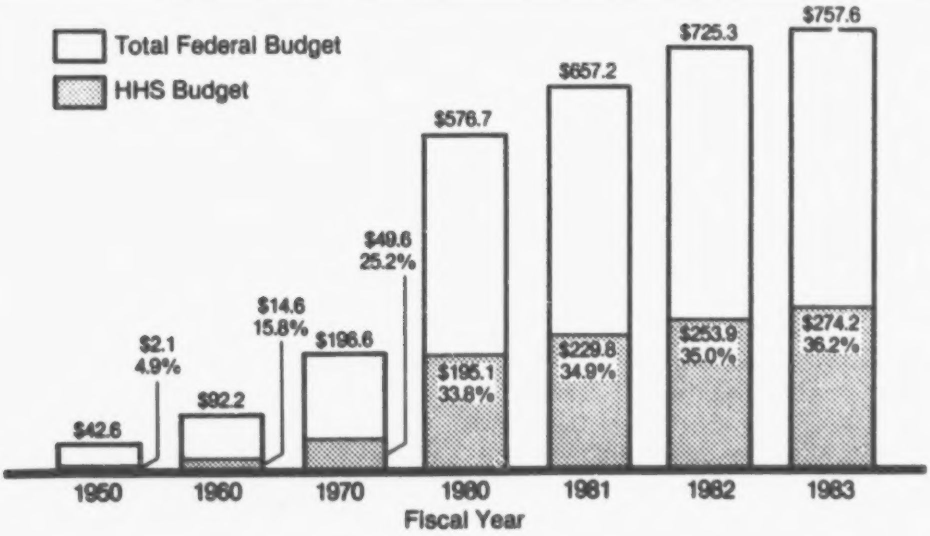
Department of Health and Human Services

1983 Budget by Function

	Dollars (in billions)	
	Budget Authority	Outlays
■ Education, Training, Employment and Social Services (Function 500)	$4.9	$5.1
■ Health (Function 550)	75.8	76.4
■ Income Security (Function 600)	187.7	192.7
Total, HHS	$268.4	$274.2

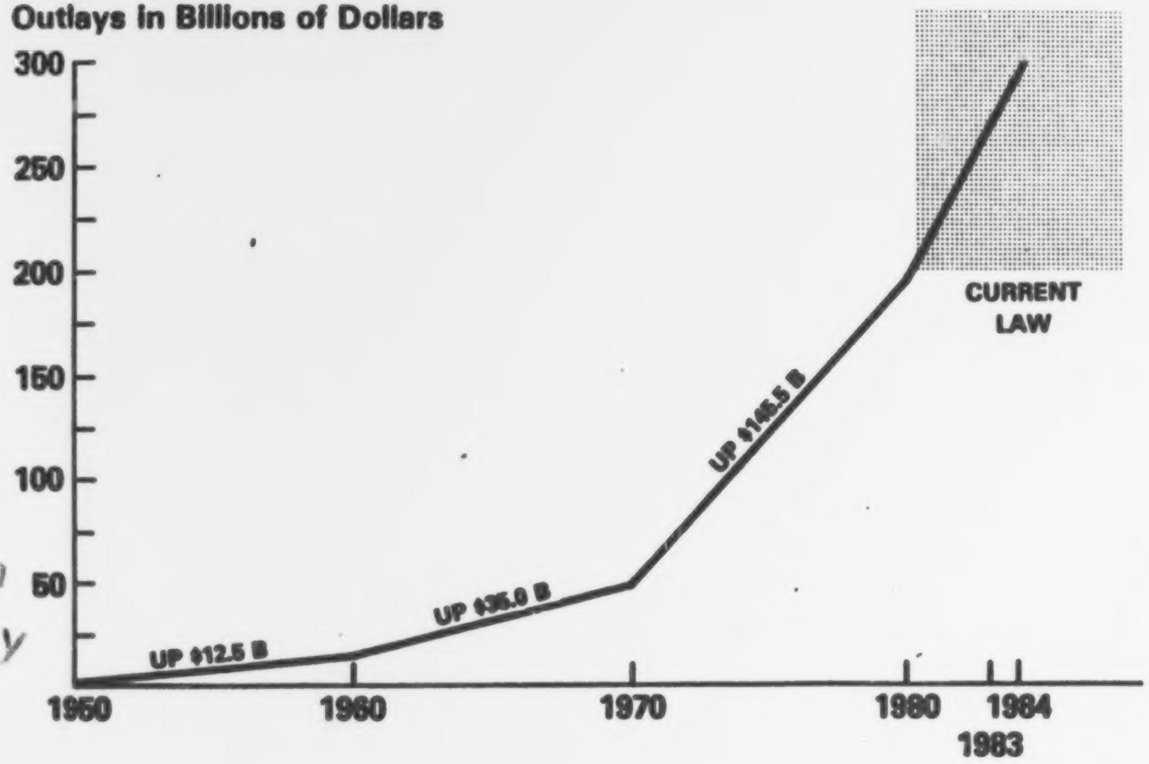
Department of Health and Human Services

HHS Percentage of Federal Budget Outlays in Billions of Dollars



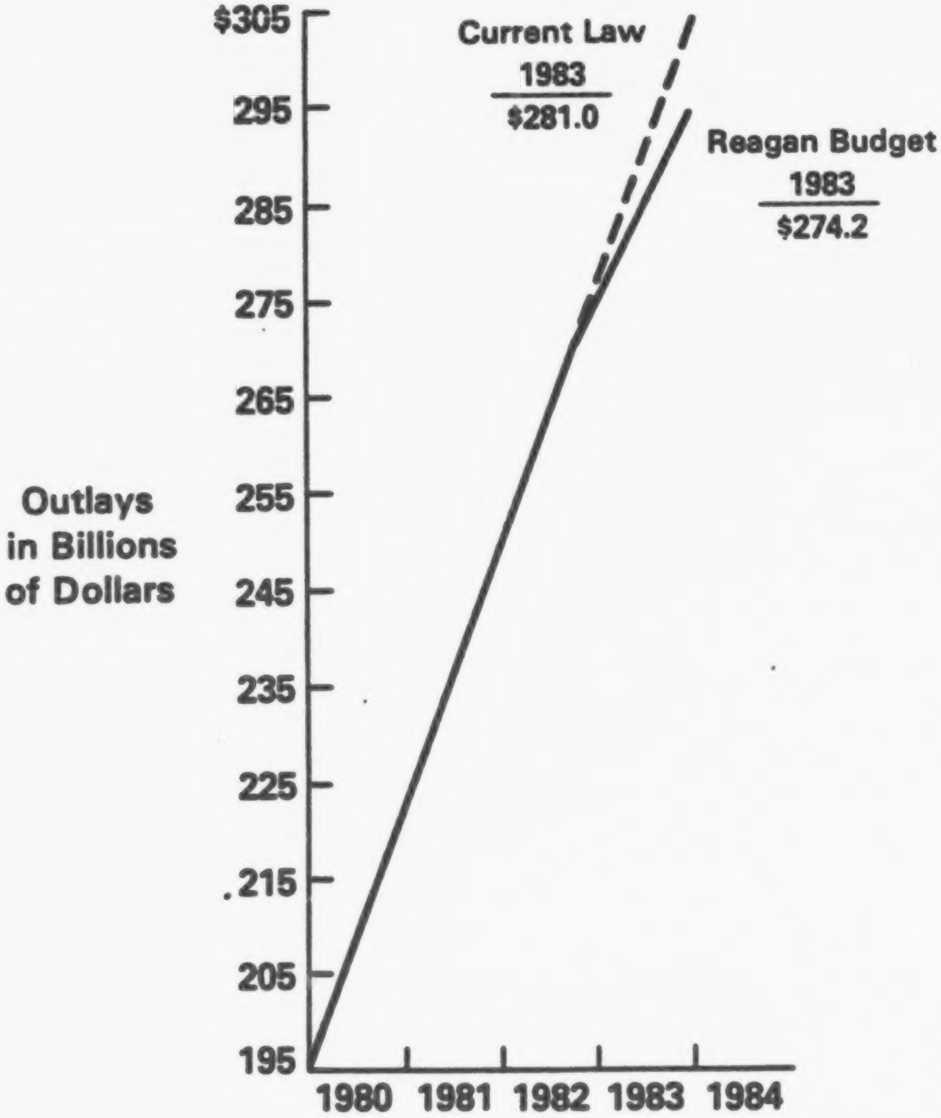
Department of Health and Human Services

Growth of HHS Programs, 1950 — 1984



Department of Health and Human Services

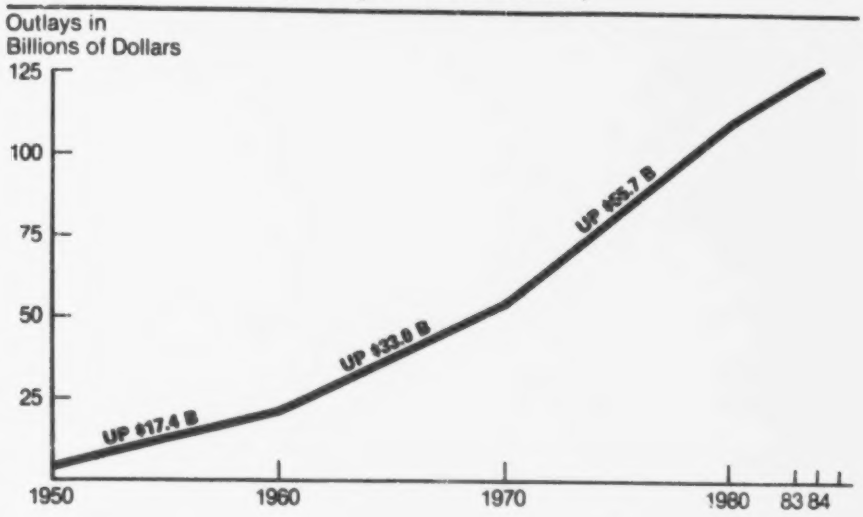
Impact of Entitlement Reforms on HHS 1983 Budget, 1980 — 1984



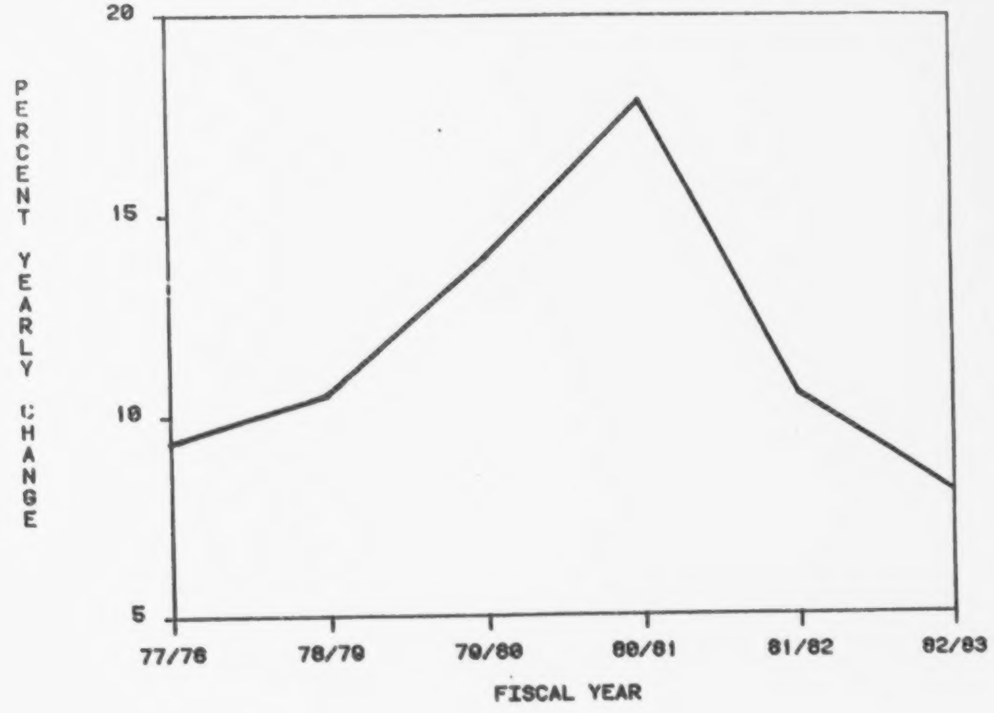
Department of Health and Human Services

Growth of HHS Programs in Constant Dollars, 1950 - 1983

(Outlays in 1972 Dollars)

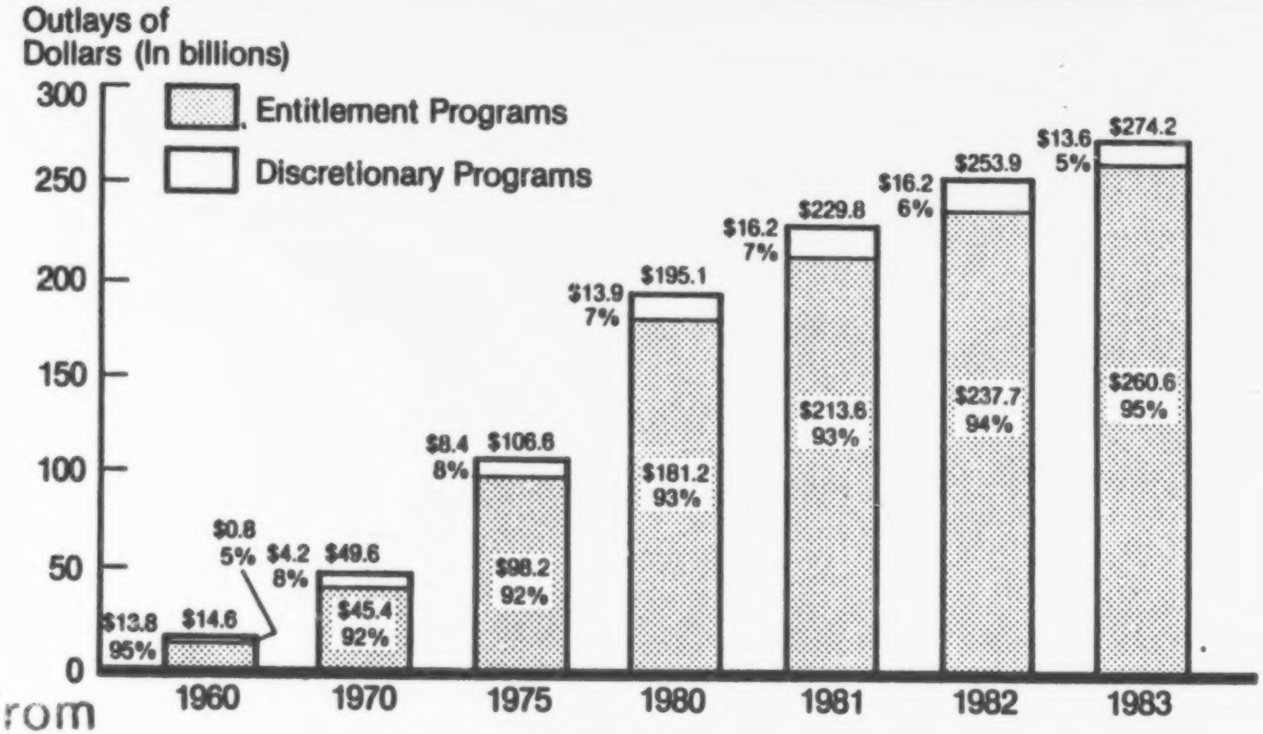


DECLINING GROWTH RATE IN THE HHS BUDGET



Department of Health and Human Services

HHS Discretionary and Entitlement Programs



BIPARTISAN EFFORT NEEDED TO BALANCE BUDGET

Senator BOSCHWITZ. Mr. Secretary, I do not want to be argumentative, but on the other hand, I agree with you when you said that if we do not change current law on entitlements, we are simply not going to have an opportunity to balance the budget.

While I agree that there is a commission that is attempting to find solutions, why don't we move forward with some means of restricting the growth of programs, not only medicare and medicaid, but social security and some of the other 300 programs. If we don't, the hope of balancing the budget or even beginning to be on the top toward a balanced budget will not be realistically achieved and I am afraid we will go forward with a continuation of high interest rates, and our economy being skewed in all types of ways.

Is not there something we can do now even in advance of the report of this Commission? We can make changes later on in the event the Commission gives us better direction but is there not something we can do now that will lead us in that direction? The administration's program leaves such a large segment of the budget untouched or increasing that we feel somewhat at a loss to know how to proceed for the purpose of achieving a balanced budget.

Secretary SCHWEIKER. Well, Senator, it certainly was not because we did not try last year. I spent a good many months last year trying to get a program through in this area, the biggest entitlement program of all. I worked very long and I worked very hard at it. I had to get a proposal through OMB, and through the Treasury. I had to get it through The White House and, obviously, we fell into some substantial guerilla warfare in terms of people differing with our approach on how to do this.

So because of that, after a very valiant effort, we tried to see if we could invoke some bipartisan effort to solve this problem.

I want to say to this committee, that this committee has been bipartisan in this area and I want to make it clear that the fault does not lie in this committee. This committee has tried to approach that problem and others in a very bipartisan way which is, frankly, the only way to solve it.

Senator BOSCHWITZ. Senator Hollings.

Senator HOLLINGS. I think Senator Exon was here ahead of me.

Senator BOSCHWITZ. Senator Exon.

TRANSFER FOOD STAMP PROGRAM TO HHS

Senator EXON. Mr. Secretary, I do not think you said particularly, if you did, I missed it, about the food stamp program.

Do you have any turf on that?

Secretary SCHWEIKER. I would like to get some, but it does not come under my Department. No, I do not, because it is under Agriculture.

Senator EXON. Have you consulted with the Secretary of Agriculture on this matter? It is in the whole general welfare area. Have you and the Secretary of Agriculture and Mr. Stockman consulted on this particular program, since it is Welfare?

Secretary SCHWEIKER. Well, in terms of the budget process, the OMB deals with each Cabinet Secretary in his own field. That is normally the way we do it. However, if a proposal affected both Agriculture and my Department in some way, I would be involved and consulted. So to some extent we would on an ad hoc basis.

Senator Exon. From time to time we have talked about consolidating some of our programs and certainly food stamps is one of those.

Has it ever been considered by this administration that it might be well to move food stamps over into your Department where many people think it truly belongs?

Secretary Schweiker. It has been under consideration. Right now, I would say that because of the New Federalism proposal, it is probably on the back burner awaiting the outcome of that. But there was some discussion of it early on. I want to make it clear that no decisive action was taken or no decision was made. So I do not want to mislead any body.

By the same token, it was under some consideration but at a low level, but with the New Federalism proposal, it has, frankly, been put on the back burner.

Senator Exon. Mr. Secretary, if we are going to understand the Governors that are dealing with the White House now and what has been coming out of the White House, I think it has been generally agreed to that food stamps would not be one of the programs that would be transferred to the State under the New Federalism program. So I imagine that will be bubbling back up to the surface again; and I would appreciate you taking a look at that, because maybe we could get better control of that if it were administered by an agency such as yours that has a lot of firsthand knowledge on this, where the administration might be more effective than it is in the Department of Agriculture.

Secretary Schweiker. I appreciate the sentiment and I will consider that if it is not in the proposal.

Senator Exon. I have no further questions at this time.

Senator Boschwitz. Senator Symms.

ARTHRITIS FUNDING

Senator Symms. Thank you, Mr. Chairman.

Mr. Secretary, we appreciate having you down here today, and I wanted to ask you two questions.

The first one is more in terms of an administrative detail with respect to the National Institutes of Health.

How much flexibility do you have in directing the emphasis of which diseases get more research dollars than the other? It is necessary, as Senator Goldwater and Cranston have suggested, if we want to see more emphasis on arthritis and related diseases, that we have to pass legislation to do that, or can you direct that administratively at NIH?

Secretary Schweiker. Well, let me say, Senator, we do have a peer review system of scientific study panels that have some say. But I am concerned about arthritis funding and we have a new Acting Director there, and I have made it quite clear to him, that I think we should be even-handed and fair in awarding that. He specifically is trying to do that.

I recognize that this is a very important disease and I would certainly concur with the sentiment. I have expressed similar sentiment to him in terms of his new job.

Senator **Symms**. Senator Goldwater and Senator Cranston are suggesting that we set up a special institute so that it will not be lumped in with the group of other diseases. I do not know whether that would add a lot of administrative cost. They say not.

Have you had a chance to do a cost analysis on that?

Secretary **Schweiker**. Let me say I have not done any specific cost analysis. We certainly could. The problem I would honestly see is that that institute also has diabetes, kidney diseases in it. It has some skin diseases in it. I am afraid if you do it for one, the others will come right back to the Hill and say, we want an institute for this disease and an institute for that disease. So while I happen to think arthritis should have a high priority, I did instruct our director to be fair.

DISPROPORTIONATE INCREASE IN SOCIAL SECURITY

Senator **Symms**. I appreciate that, when you consider one out of six people are suffering from it. It seems we ought to emphasize the dollars we are spending.

I thank you for that.

I showed this document to Dr. Meyer, who testified ahead of you. It shows growth in social security and civil service retirement benefits versus growth in CPI and wages from 1970 to the present. If you will note right here, this is the growth of the cost of the CPI from the base line of 1970. This is the increase of average weekly earnings in the country and over here is social security—this has gone up 121. The CPI, 149, social security is up 205 percent. As opposed to these other factors in the economy.

Now, in view of the fact that Senator Hollings pointed this out, that not only that—I think we would agree, until this Congress gets control of the so-called uncontrollables, we are not going to achieve a balanced budget.

Would you agree with that?

Secretary **Schweiker**. I agree with that. I said that earlier. That has been the message of my testimony on the Hill. I sit on top of the volcano.

Senator **Symms**. If we do not get that down, we will not get interest rates down. If we do not get interest rates down, we compound the problems of your Department, because we have more people on unemployment and more people demanding services from the Government. I doubt if we could wait, personally, as one Member of the Senate, for one Commission to give up a report.

I just wonder if in this committee, if we come out with some recommendation, that addresses this problem, where you see that social security spends $12,800 a minute more than it takes in in revenue, and you look at the facts and see for the 12 years there has been a disproportionate increase in social security compared to working men and women of the country.

So I do not see how we could wait 3 or 6 months, until we get a report. This is in a proposal similar to Senator Hollings or some other fashion to try to bring these two back into equity.

Otherwise, you have everybody in the country under 50 resenting everybody in the country over 65 and Congress cannot get control of interest rates and we cannot get economic recovery.

How can we wait until 1983?

Secretary **Schweiker**. That was my thesis when I moved ahead in 1981. I was the guy out in the middle of the fire fight and everybody started laughing. I agree with you. Your premise is correct. I did my best. It obviously was not good enough, but I certainly am a believer on that thought.

Senator **Symms**. Well, are the proposals that you put forward last year null and void, then?

Would they also be considered offsets?

Secretary **Schweiker**. Put it this way. The President, in appointing a Commission, specifically wanted to give them an open book to look at anything available. So he did not want us to in any way prejudice or influence the deliberations. So at this point, my instructions are clear; that they are able to pursue any aspect of this, including the proposals we made and the proposals we did not make.

NO INCREASES FOR ANYBODY UNTIL BUDGET IS CONTROLLED

Senator **Symms**. How about just a simple no increases for anybody until the Commission makes their report, with the intention that we will get it fixed after that, to give the signal to the market? How would that be?

Secretary **Schweiker**. Well, that would not be in consonance——

Senator **Symms**. That would not break your heart if it happened against your recommendations?

Secretary **Schweiker**. Well, let me say this: It is clear——

Senator **Symms**. You have not got the man in the White House convinced yet.

Secretary **Schweiker**. I am clear what our position is in the administration, and I support it. I also think it is clear that the administration is obviously open to suggestions and ideas and obviously any positive, constructive efforts on the part of Congress, are going to be considered.

Senator **Symms**. The reason I suggest this, when we came in here a year ago, I suggested to this committee that we have not any increases in government wages and salaries or any entitlement programs, period, until we get control of the budget and people at that time, a year ago, they kind of scoffed and laughed at you for suggesting that, and I think Senator Hollings will vouch for that. People said, you just cannot do that.

Well, the market has been laughing at the Congress for a year. Now the public is not laughing at it and I can assure you that the public support, the grandfathers of this country, are telling me when I go home to my State, do not raise my social security benefits because my house is paid for; my car is paid for, I have got savings in the bank and in a lot of cases they are saying that; and my grandson cannot buy a house because interest rates are too high.

I think the thing has changed since last year with the public support, and I think we ought to move now. We cannot wait another year. Too many people are hurting. I would agree that some lady that is a widow that gets $275 a month, surely there is enough flexibility in this system to give them some kind of a stipend of an increase. But the big bulk of those 36 million Americans that are on social security are better off financially than the people that are paying into it, in a lot of cases. It is a giant chain letter that is paying out money faster than paying in.

I would urge you to go down to the Cabinet meeting this week and urge the President that the situation is changing very rapidly as people are becoming more aware. I think if you could get the President to go on television and tell the American people the facts about social security, they would support the administration and the Congress, to fix it, and fix it this year, and not wait for next year.

Thank you.

Thank you, Mr. Chairman.

Senator BOSCHWITZ. Thank you, Senator.

Senator Chiles?

CUTS IN AID TO FAMILIES WITH DEPENDENT CHILDREN

Senator CHILES. Mr. Secretary, the administration is proposing a series of legislative changes to the aid to families with dependent children. Those are designed to save another billion dollars on top of what we cut last year.

For example, one of your proposals is to count low-income energy assistance as income so that welfare payments would be reduced. The CBO recently published a study requested by Senator Hollings, I think, of last year's package of spending cuts and said they will take a total of $4.5 billion away from the lower-income people and give $15.9 billion to the people with over $85,000 a year. That means an average reduction of $240 a year per household for the lowest income groups and then an increase of over $25,000 for each household over $80,000.

I have a table that I will insert for the record.

[The following was subsequently received for the record:]

SUMMARY TABLE 1. NET CHANGE IN FEDERAL INDIVIDUAL INCOME TAXES AND FEDERAL BENEFIT PAYMENTS FOR INDIVIDUALS BY HOUSEHOLD INCOME[a]: CALENDAR YEAR 1983 (in 1983 dollars)

	All Households	Household Income (in 1982 dollars) Less than $10,000	$10,000-$20,000	$20,000-$40,000	$40,000-$80,000	$80,000 or more
Change in Total Federal Taxes and Benefits (in millions of dollars)						
Cash benefits	-11,950	-5,190	-2,960	-2,740	-990	-80
Taxes	82,130	2,340	9,290	28,720	25,780	16,000
Net	70,180	-2,850	6,330	25,980	24,790	15,920
In-kind benefits	-5,560	-1,680	-1,610	-1,430	-790	-50
Net including in-kind benefits	64,620	-4,530	4,720	24,550	24,000	15,870
Change in Average Federal Taxes and Benefits per Household (in dollars)						
Cash benefits	-140	-270	-140	-90	-70	-70
Taxes	940	120	440	950	1,830	15,250
Net	800	-150	300	860	1,760	15,180
In-kind benefits	-60	-90	-80	-50	-60	-50
Net including in-kind benefits	740	-240	220	810	1,700	15,130
Change in Federal Taxes and Benefits as a Percentage of Income						
Cash benefits	-0.5	-3.0	-0.6	-0.3	-0.2	b
Taxes	3.5	1.3	1.9	3.2	4.6	6.7
Net	3.0	-1.7	1.3	2.9	4.4	6.7

SOURCE: Congressional Budget Office

Senator **Chiles**. How do you respond to the criticism that last year's reconciliation bill has already sharply cut the aid to families with dependent children and eligibility levels and further cuts would just be unfair?

Secretary **Schweiker**. Well, there is no question that we did make some cuts in the program last year, and we are trying to assess the impact. We believe there still are some further cuts that can be made. We certainly will try to keep an open mind on whether the impact would be fair and evenly distributed.

I realize there is an honest difference of opinion as to what levels of welfare should be and in terms of income levels. These are our differences and they are honest differences.

MEDICARE/MEDICAID LACK COST-SAVINGS INCENTIVES

Senator **Chiles**. I understand the appeal to the Governors having the Federal Government take over the medicaid program. That has been a growing cost. My concern comes when I look at the problems we have had in trying at the Federal level to control cost increases as well as outright fraud and abuse in medicaid.

It seems to me that the only action to set up cost controls and rate review commissions and fraud and abuse investigation units have come from the State. With each State paying half of the cost of medicaid, there was a real incentive on their part to control costs.

I remember back in 1975 when we started investigating error rates and growing costs in the food stamp program, we found a basic structural problem, that the case-by-case determination of income and eligibility levels was made by State workers with the Federal Government paying 100 percent of the cost. There was simply no incentive to hold down costs. Why would not we have the same kind of situation if we have the Federal Government paying 100 percent of the cost of medicaid. What is the incentive on the part of States to see that they hold down the costs and that they provide the services?

Are you still going to use the States to certifying providers of care, or do you intend to set up a Federal bureaucracy to handle that?

Secretary **Schweiker**. You are talking as if it is federalized?

Senator **Chiles**. That is right.

Secretary **Schweiker**. Well, let me say I agree somewhat with your thesis that if this program was going to be continued in its present form, we would certainly have some problems with it.

The thesis I am going under, and we are working on now, is that we have to make some changes in our medicare/medicaid program anyway and we certainly have to make them if we federalize medicaid. We cannot tolerate the lack of incentives to save money, the lack of incentives for competition, the lack of incentives to get cost efficiencies. So, in any case, we would have to make some major changes in the programs we administer if we assume that burden.

I would agree with the rest of the question, and we are working on some way, not from the standpoint of whether it is federalized, but from the standpoint of where we are now with both medicare and medicaid.

One of them, quite frankly, in addition to our competition proposal, is prospective reimbursement.

Prospective reimbursement is one of the ways to go, and that could apply to both medicare and medicaid, I think it is important that we make the structural changes, particularly if the program is federalized.

Senator CHILES. Well, have you made a determination now if you federalize medicaid as to whether you are going to use the States as the conduit, as the people are determining eligibility or not or whether the Federal Government will take over that responsibility?

Secretary SCHWEIKER. Senator, I prepared an options paper for the President that had five options. One side of the coin was to totally federalize the programs. The other side of the coin was basically a block grant program with 100-percent funding from the Federal Government but the States running it. There are some graduations in between and the final cut on these options is awaiting the outcome of the negotiation with the Governors. So there are two or three basic models we are looking at to do it.

Senator CHILES. I see a real danger if there is no incentive on the part of the States.

Secretary SCHWEIKER. I agree with that. I think if we take the burden, we have got to put incentives in the system and change the infrastructure or we are leading with the chin. So I agree with the question.

DISINCENTIVES TO HIRE OR RETAIN OLDER WORKERS

Senator CHILES. In working on problems such as the economic conditions of the elderly, I have become sensitive to Federal policies that create disincentives to hire or retain older workers. My concerns are twofold: first, as modern health and medical trends allow people to stay healthy and active to late ages, it seems like we need to adjust policies to allow older people to play an active and productive role in society; and second, if we can lead to the long-term problems of social security in the face of an aging society, we have to have those older workers remain healthy as contributors to social security rather than being dependents. What concerns me is your proposal to eliminate medicare benefits for older workers and make the private employers pay private health insurance. We might want to make that change later on when the employers are used to keeping on older workers. But right now it is an extra cost and would be an unwise policy and would cost more than it would save.

Do not you think that that particular program change would create a disincentive to hire and retain older workers?

Secretary SCHWEIKER. Well, first, I agree with the thesis in your proposition. But if you look at our proposals that we made last year in social security, they kept an incentive for working longer and in addition they included eliminating the earnings limitation for older workers for that specific reason.

One other aspect of this is that we believe that the change we are making to the average employer will not be that significant because basically we feel that the older employee has a lot to offer—

the employee will provide a skill, a constancy of employment as opposed to absenteeism, immediate know-how to continue on the job which we believe will outweigh any additional costs. Overall, the small adjustment the employer will have to make would have only a slight impact. If it were a significant negative impact, I would agree with the thrust of your question.

Senator **Chiles**. Well, I must say I agree, if he keeps people on very long. I think the evidence has shown those companies that have provided incentives had a very positive impact on the absenteeism rate. It is better than it is almost for the average age worker, that they are not accident-prone, they do not tend to move around and they can be retrained. But our problem is we still do not have a lot of employers who know this yet and they are so used to trying to get rid of people at the age of 62 or 65, to try to get them out of the system, that it seems like to me we have to do everything we can to encourage them to keep older people on, so these items will be proved out to them and I am afraid your proposal would be a disincentive in that regard.

Thank you, Mr. Chairman.

Senator **Boschwitz**. Thank you.

Senator Quayle?

PERCENTAGE OF ENTITLEMENTS VERSUS DISCRETIONARY FUNDING

Senator **Quayle**. Thank you, Mr. Chairman.

I am intrigued by one page of the data you handed out where you compare 1960 through 1983. If you look back at 1960, 95 percent of the budget at that time was for entitlement programs and in 1983, 95 percent of the budget will be for entitlement programs: 5 percent discretionary in 1960 and 5 percent discretionary in 1983.

So with respect to the percentage of entitlements versus discretionary funding, the Department is at the same place it was in 1960 according to this data. The alarming thing to me is not the percentage, because the percentage of discretionary versus entitlement is essentially the same today as it was in 1960. However, in 1960, $13.8 billion was spent on entitlements—now it is up $260 billion; discretionary spending in 1960 was less than $1 billion and now it is $13.6 billion.

Mr. Secretary, of the $260 billion that we have in the entitlements programs, how many programs are there?

Secretary Schweiker In terms of——

NUMBER OF ENTITLEMENT PROGRAMS

Senator **Quayle**. The number of programs in the entitlement programs. How many programs do we have? Do you have any idea?

Secretary **Schweiker**. While we are looking that up, let me answer the first part of your question.

Senator **Quayle**. It was just an observation. But go ahead.

Secretary **Schweiker**. The reason that 1960 and 1983 have the same percentage, is that in 1960 there were only about 150 categorical programs and today there are about 500. While the percent is the same, it is a different ball of wax because you spread the money around 150 programs. Now we have 500 categorical programs. So while the percentage is not changed, there are so many more interest groups, and so many more people that want help in their respective programs, I think that has changed a little bit and while it does not disprove anything——

Senator **Quayle**. No, but the increase in programs is reflective of the increase in the actual budget, not necessarily the relationship of entitlement spending versus discretionary.

In response to Senator Hollings, you were saying we ought to cut more out of the entitlement rather than discretionary spending. I would just point out that we have not really changed since 1960. I am curious how many programs we have in the entitlement programs.

Secretary **Schweiker**. I can give you mine: Social security, medicare, medicaid, aid to families with dependent children, and child support enforcement, supplemental security income and benefits for coal miners. Those are the major ones in my department.

Senator **Quayle**. What is that, 10, 12?

Secretary **Schweiker**. Six basic ones.

Senator **Quayle**. You only have six entitlement programs?

Secretary **Schweiker**. Right.

Senator **Quayle**. I understand that there are about a total of 86 entitlement programs, if my figures are correct. So there are very few so-called entitlement programs in your department, but they take a big chunk of the budget?

Secretary **Schweiker**. That is right.

PROGRAMS HAVING AN AUTOMATIC BUILT-IN INDEX

Senator **Quayle**. Now then, of the entitlement programs that total $260 billion, how many are automatically adjusted annually for the CPI?

Secretary **Schweiker**. No, social security is. Medicare and medicaid are not adjusted by it but the impact is the same because of the way we reimburse.

Senator **Quayle**. Is there an automatic trigger to all these programs, whether it is CPI or some other mechanism?

Secretary **Schweiker**. The automatic trigger would be in social security, supplemental security income and coal miners

Senator **Quayle**. So there is an automatic built-in index of all these programs?

Secretary **Schweiker**. Yes, in these three programs. It is important to say that because of the way we reinburse now, if medicare prices go up 18 percent, we just pick up the bill. So the extent that general inflation keeps pushing up medicare and medicaid, we reimburse. It is almost like cost-plus. While they are not directly tied, indirectly it is and that is part of the problem.

Senator **Ouayle**. That is on medicaid-medicare?

Secretary **Schweiker**. Medicaid-medicare.

FREEZE ENTITLEMENT PROGRAMS AT CURRENT LEVELS

Senator **Quayle**. What kind of savings would you have if in fact the Hollings proposal of just freezing Government spending at the 1982 level would be adopted by this Congress?

Secretary **Schweiker**. I do not know but we sure can get that for you.

Senator **Quayle**. Senator Hollings' proposal seems pretty good to me and others that are looking for a way to get a handle on these problems. It comes from the other side of the aisle, and gives that flavor of bipartisanship that we are all so diligently looking for. What would be the administration's response to freezing these entitlement programs at current funding? What is your personal reaction? I think I know the administration's reaction, but could you put your personal hat on?

Secretary **Schweiker**. My personal situation is that I led the battle, I fought the fight last year, and I lost it and I got a little bloody on it. I have been pretty clearly instructed that we are to work with the new Commission and await the outcome of that Commission. The administration is certainly going to look at any effort on the Hill that is bipartisan and meaningful. So I do not think it would be downplayed or denigrated.

Senator **Quayle**. Let me put the question a little differently.

If we adopted the Hollings proposal on freezing entitlement programs at current levels, what kind of statutory change would we need? Would we have to go to do away with the cost-of-living adjustment? What would we have to do with these programs on a statutory basis? Are we talking about substantive changes and, if so, what precisely are we talking about?

Secretary **Schweiker**. What you are talking about is a statutory change. Whether it is substantive or not, I guess would be debated. It is a statutory change. It would have to pass both houses. There are some people in the other body that have made some direct statements that it would not pass. But it is a statutory change.

GIVE CONGRESS POWER TO CHANGE ENTITLEMENT FORMULA

Senator **Quayle**. If you wanted to give us advice on how to get a handle on entitlement programs, which everybody says they want to do, what would you suggest?

Secretary **Schweiker**. Well, I think that one of the things that I would do is change the infrastructure of the Congress a little bit.

Senator **Quayle**. Change the infrastructure of the Congress?

Secretary **Schweiker**. Yes, sir. I would put the entitlements on a specific track so that when they came up to the Congress, either the Budget or the Appropriations Committee would have the authority within a certain limit to make an adjustment that somehow would balance the resolution out of the Budget Committee. As you know, I have served in both the Budget Committee and the Appropriations Committee. Now 95 percent of my budget is entitlement which requires changes in law to control their growth. You go to the Appropriations Committee and, as Senator Hollings and Senator Chiles and some others know, when an appropriation bill comes out of my Department, about 80 percent of it is set by entitlements if you exclude the trust funds. So you can tell them to cut the budget but they cannot cut the budget because they can only control 20 percent of it. I suggest giving this committee, or the Appropriations Committee, the legislative authority, if the authorizing committee has not acted to meet that imbalance, to take action at the end of the appropriations process. This is where we are in a bind. We write off about 80 percent of the budget in this appropriation bill because nobody can touch it. I think you could investigate it with the authorizing committee, and say if the budget resolution cannot make ends meet, you have to change the entitlement formula and if you do not do that, then the Budget or the Appropriations Committee has the authority to do it in lieu of your default. I think that is the only way you are going to give the infrastructure the power to do it. The other thing this would do is get the Budget Committee and the Appropriations Committee working together with the same objective and I think that that would be constructive. I would give the responsibility first to the authorizing committee but if they do not do it, if they do not do what this committee says is the budget mandate and do not live within it, I think by default you go to this committee and/or the Appropriations Committee should have the power to adjust an entitlements program in the final appropriation package.

Senator QUAYLE. Would you want to give any of that power of adjustment to the executive branch as well?

Secretary SCHWEIKER. I would consider that, yes. I think we do need to fine tune this.

ENTITLEMENT REFORM

Senator QUAYLE. Is the administration working on a proposal that would be labeled Entitlement Reform that would deal with the infrastructure here or in the executive branch? If so, I am sure a lot of us would be interested.

Secretary SCHWEIKER. I have a task force in my own Department that is working on it and considering some of those ideas.

Senator QUAYLE. Are you going to be recommending them at sometime in the near future?

Secretary SCHWEIKER. First I have got to get them out of my Department and through the administration.

Senator QUAYLE. In the short term, what can we do?

Secretary SCHWEIKER. In the short term I do not see anything wrong with putting something in your reconciliation package that somehow places the responsibility a little more clearly with the authorizing committee and if they do not act, then give this committee or the Appropriations Committee the power to do something this year. In other words, change the law. Now we are proposing $6.8 billion of cuts in this package which should be adopted. That is what we think is a beginning on this problem.

BIPARTISAN AND BI-INSTITUTIONAL EFFORT NEEDED

Senator HOLLINGS (presiding). Thank you, Mr. Chairman.

With all respect, Mr. Secretary, the Budget Committee does have that authority. But, the worst thing to do is ask, even though that is the courteous approach, because being politically pragmatic, the authorizing committees generally come in way above and beyond spending levels that we are able to afford. You know that certainly is the case on the Appropriations Committee. Right now, all these committees are coming in with some $17 to $18 billion of increased spending rather than cuts. I do not think it is a lack of authority. We on the Budget Committee, with reconciliation, can offer an amendment to cut spending. So the authority is there. I think what the distinguished Senator from Indiana is pointing out, in a very colorful way, is it has got to be bipartisan in the sense that it also has to be bi-institutional. It is not only the congressional branch but also the Executive that has to lead the way.

I commend your leadership. I know you were burned last year. We on the Budget Committee were burned some. But to talk about the Commission; that is not to solve any economic problem but is to solve the political problems of the Congress. We know that because there is no mystery to the solution of the social security problem. You can come up with various formulae as to how much you receive and actuarially work it out, just as every insurance company sits about doing when they meet with the actuaries.

MAJOR PROGRAMS FOR POOR HAVE DECLINED

Now the major programs for the poor, I want to correct that record. They have not been growing that fast. Take supplemental security income, aid to families with dependent children, medicaid, food stamps. As a percentage of Federal outlays, they have actually declined since 1976. These programs were 6.8 percent in 1976; 6.7 percent in 1977; 6.4 in 1978, and this year, 1982, they have fallen to 6.1 percent. The real growth areas are Federal pensions and social security COLA's.

I would hope that you would retain your leadership in the executive branch on that particular score because I think it is fundamental to the economy, to the Congress, and to Reaganomics. I would like to see Reaganomics work. We are not asking to do away with the supply side, with the tax cuts, with the increases in defense, or with the cuts in regulations. This is not an anti-Reagan or anti-Reagonomics program. But until we take advantage of the incentives that obviously influence the business side, we will have difficulty getting interest rates down. We are in a "catch-22" situation. Unless we can do something about your budget, which is you said $274 billion—we will never get Federal spending under control.

How many employees do you have now?

NUMBER OF EMPLOYEES EMPLOYED BY HHS

Secretary SCHWEIKER. We have about 11,000 less than when I took over so we have about 144,000.

Senator HOLLINGS. You have way more than that.

Secretary SCHWEIKER. No, the Defense Department is way ahead of me on employees.

Senator HOLLINGS. How about the Social Security Administration—are you counting them?

Secretary SCHWEIKER. Employees?

Senator HOLLINGS. Employees. Well, Health and Human Resources—Education is out.

Secretary SCHWEIKER. 144,500.

Senator HOLLINGS. I will have to regroup. I remember when you and I were here and Secretary Califano came up with a figure that was over 1 million. Something is wrong. People who worked on grants and——

Secretary SCHWEIKER. If you count State employees who we——

Senator HOLLINGS. Yes.

Secretary **Schweiker**. But they are hired and fired by the State.

Senator **Hollings**. Who are they paid by?

Secretary **Schweiker**. Well, we maybe pay half of their salaries.

Senator **Hollings**. That is right, half of their salaries. So that in essence they are Federal employees because we appropriate for them.

Secretary **Schweiker**. We have no control over them. So are they our employees or not? I think an employee on your staff would not be considered by you to be an employee if you did not have control over them.

Senator **Hollings**. Continue, please, and do not get discouraged, please. My colleague from Tennessee has some questions. But I want to commend you. There is no question that you have a grasp on your Department and a sensitivity to its needs. In my opinion you are doing an outstanding job.

The only thing is, of course 'in the field of trying to do something on the matter of entitlements. Therein I guess we got the President and Speaker O'Neill to agree for the first time. The President said put up or shut up and I put up an alternative and both the Speaker and the President said shut up. But that does not mean that you should shut up. That is, follow up on your offer of reviewing any suggestions that we have along this line and work in a bipartisan fashion, Mr. Secretary.

Secretary **Schweiker**. Let me say this: I appreciate this—this committee has been in the forefront of trying to deal with this entitlements question. My hat is off to them because unless we do, we will not win any battles in any area. I am willing to work with this committee because I realize there is no solution unless we do this together.

Senator **Hollings**. Thank you.

OPENING STATEMENT OF SENATOR SASSER

Senator **Sasser**. The disability insurance program is, as you know, the primary source of income replacement for workers and their families who are unable to work due to a disability. This presently covers about 4.5 million individuals in this country.

TERMINATION OF DISABILITY BENEFICIARIES BY QUOTA SYSTEM

In 1980 the Congress passed amendments to the program which require that, unless a disability beneficiary had been diagnosed as permanently disabled, he or she had to be reexamined every 3 years. This change to reexamine them every 3 years was to go into effect in January 1982. The administration accelerated this and started the reexaminations over 1 year ago, really 9 months ahead of schedule, I am told. Horror stories are abounding of individuals being terminated from the disability rolls with little or no evidence that the individual is not disabled. The Social Security Administration has confirmed that almost one-half of those individuals who are reexamined are terminated and denied further disability payments. Yet, the same individuals come along, according to the General Accounting Office, and over 70 percent of the cases are reversed by administrative law judges on appeal. In other words, 7 out of 10 of the individuals terminated from the disability rolls are being reinstated on appeal. But it takes sometimes as long as 1 year for the appeals to be exhausted and for them to be reinstated. This, I am told, is causing severe distress to many who are taken off the disability rolls and later go through the appeal process and find that indeed, yes, they are disabled.

It is also causing some distress for those social security employees who are taking part in determining who is terminated. I am getting reports from my State that State agency employees are being told to make the determinations about who should be taken off disability or terminated from disability on the basis of a quota system.

My question to you, Mr. Secretary, are you aware of any quota system for terminating disability cases?

ERROR RATE OF 20 PERCENT

Secretary **SCHWEIKER**. First of all, there is no quota system on that. But I do want to explain one thing that has a bearing on your question, Senator.

The General Accounting Office made a study of our Department a year or two ago before I got there and said we were making 20-percent error rates on disability awards and it was costing the taxpayers $2 billion. Now, a 20-percent error rate is a pretty bad mark. I will be honest with you. Frankly, we are trying to tighten up our disability program because of the 20-percent error rate and the cost to taxpayers of $2 billion a year to people who should not get the awards that are. We have quite an error margin to deal with.

In addition, you know, people do not realize I have the largest judiciary system in the world in my Department. I have 700 administrative law judges. We fund them and pay them. So, we have to manage them. One of the problems is that these judges are not easy to manage. Yet, we have got to manage or I am held accountable by GAO for blowing $2 billion. By the same token, if we are not all on the same wave length, reading the same criteria, awarding the same disability awards, we have got a problem.

So, I hear what you are saying, but we have a way to go on improving our error rate. We will try to be fair. I think the implementation of standardized criteria may result in a reversal rate which is different than the 70 percent figure, which was an older figure.

INJUST TREATMENT OF DISABILITY RECIPIENTS

Senator **SASSER**. Mr. Secretary, I would like to read you a letter that I received from an individual who works in the social security office in Memphis, Tenn. It is written on what appears to be a government form. The letter says, and I quote: "Dear Sir, I am an employee of the Social Security Administration, Memphis Division. I am writing in regard to the injustice that we are doing to some social security disability recipients who have paid into the system for years. We are in fact meeting a quota system to satisfy the administration higher up and keep our jobs. We are paying doctors $70 per evaluation, sometimes for 10 minutes, and we are using doctors that are in sympathy with the administration's desires."

The writer goes on to say this: "I am a Christian person and do not believe in this. I think the whole reevaluation should be halted until an investigation is made of the administration files and the doctors that are being used. To see this injustice goes against my principles. I could not sign my name because I would be dismissed immediately, but an investigation will prove what I stated."

"Our supervisors are also scared to say anything for fear of losing their jobs."

She goes on to say—I say she. It looks like female handwriting. She says, "I feel better about putting my thoughts on paper. Please help."

That is distressing to get, Mr. Secretary. I am sure it is distressing to you to hear that. There is a lot of human suffering which may be occurring because of the administration's haste in accelerating the review of such a large number of cases.

I realize it is imperative that the Federal Government try to cut back as much as we can, but I think we will both agree that it is also imperative that we uphold a minimal degree of fairness and equity in the treatment of those who are unfortunate in our society. I think you believe that. I would appreciate it very deeply if you would check into this situation as to whether or not we do indeed, somebody is imposing a quota system, and give a report back to this committee on it.

Secretary Schweiker. I certainly will, Senator. Believe me, if there is any such quota system, it will certainly be uprooted and prosecuted.

Let me say that, as soon as you give me a copy of that, we will have the Inspector General on the case.

Senator Sasser. We will sure do it.

Thank you, Mr. Secretary.

Senator Boschwitz. Thank you very much, Mr. Secretary. Senator Exon?

MEDICARE AND MEDICAID CHANGES HAVING OPPOSITE EFFECT

Senator Exon. I have one quick question. Mr. Secretary, I want to join my colleagues in thanking you for being here. You are one of our group, and we are delighted to have you back on the Hill once again.

Do not be too discouraged. Your first chart that you put up indicated that you spend more money, your budget was larger than any other. Secretary Weinberger is making a big bid, he is coming up on you very fast. Maybe you are going to lose out in the near future.

Secretary Schweiker. We are $56 billion ahead next year. It is going to be a hard way to catch up, I'll tell you that.

Senator Exon. One question that keeps coming up all the time, and I would like to have your response and explanation for the record, is this. Many people are saying that some of the changes that have been made in the way the welfare grants are figured with medicare and medicaid, that many of these changes that have been instituted actually have had the opposite effect for which they were supposedly intended in that more people are going on the welfare rolls and we are actually increasing the load and increasing outlays of the Government rather than correcting fraud, waste, and abuse, or whatever connotation you would like to put on it.

Would you please give the Department's view of this? I am sure that you have heard it over and over again. I have had lots of letters on it.

Secretary SCHWEIKER. Senator, at this point in time we have not yet received any figures to indicate that that is true. I want to say, to be objective, the program just got under way October 1. Reporting and accumulation of data, obviously, take a few months. So, we are keeping a tight watch on it. We will keep the committee informed. Right now there is no indication along that line except for whatever we would expect because of the recession, which obviously is a factor. But I assure you that I am going to keep a personal watch on that because I think it is a very important point.

PEOPLE ENCOURAGED TO STAY ON WELFARE

Senator EXON. One thing that I have heard of, Mr. Secretary, on frequent occasions is that these people get down to such a close figure that they are encouraged to stay on welfare essentially because they cannot afford to assume the liability for their health needs that medicare and medicaid would otherwise provide. I am referring to that particular factor. Have you checked that part out?

Secretary SCHWEIKER. One of the interesting statistics which is pretty solid relates to how much of a supplement you give the working poor. The interesting statistic that we do have in our Department shows that, before we had the supplement to the working poor, which goes back to about 1967, the percent of people on welfare before that period and then after that period, when we supplement the working poor, has remained constant, about 14 percent. In other words, all the years of supplementing it on the basis that it was a step up the ladder, and that it was a way to get people off welfare, indicates that the percentage of working welfare recipients has remained at about 14 percent. There has been virtually no impact of the supplement for working poor.

In addition, we have some indications to the contrary. Back before 1967, we had a figure of about 30 percent of the people on welfare left because they got a job, and went off; and now only 10 percent do. So, if anything, I could make a little bit of a case the other way. I do not think it is necessary to make a case either way, but our statistics do not agree with that.

Now, we do have a work requirement, obviously, built into the program, so that to some extent, if there was an incentive to go off work, they could not because of the work requirement. So, while that is a theoretical assumption, the statistical history is not in that direction.

But we are going to watch it. I agree, if the trend is that way, it is a counterproductive trend; and we want to reverse it.

Senator EXON. Thank you, Mr. Secretary. Thank you, Mr. Chairman.

Senator BOSCHWITZ. Thank you, Mr. Secretary. I hope, as you go back to the councils of government, you will take with you some of the feeling expressed by this committee. There is significant bipartisanship in the feeling that the large part of the budget that your Department oversees must indeed be reined in. The programs, whatever they are, must in some way have their growth halted if we are going to really bring about a budgetary improvement. That, I think you will agree from this afternoon's hearing, is a bipartisan feeling held by a number of members on this committee.

Secretary **Schweiker**. I think that is important. I will certainly convey that to the White House.

Senator **Boschwitz**. Give them my regards. Thank you very much, Mr. Secretary.

The next panel is the Honorable Hastings Keith, Dr. Rita Ricardo-Campbell, and Dr. Barry Bosworth.

We are pleased to have you here. The order of testimony will be Mr. Keith, Ms. Campbell, and Dr. Bosworth. Mr. Keith, I believe that Senator Hollings wants to welcome you.

FAIRNESS AND EQUITY IN FEDERAL PENSION PLAN

Senator **Hollings**. I have been waiting a long time to welcome Mr. Keith, Mr. Chairman. The fact is, if anyone is responsible for saving some $3 billion and the loss of talent from Capitol Hill, it is Mr. Keith and his persistence in trying to bring us fairness and equity in our Federal pension plan.

I happen to revere public service. I admire Federal employees. I have been a public employee myself since the 1940's. In essence, we have enjoyed some things that have not been equitable and have been very costly to our budget. Your articles and positions have helped us save literally billions in this particular area, Congressman Keith. I wanted to commend you for it.

I am already late at another hearing, but I wanted to make that comment.

I have read your testimony. It will lend support to us for a rational and balanced approach to this entitlement program. No one wants to cut entitlements because they are almost like a trust. You pay for a particular benefit. You expect to be entitled to it.

But our distinguished chairman more or less analyzed it a little bit ago with his comments on the effects of Presidential candidacies, the semiannual adjustment, and the 1 percent kicker. Between those three things costs skyrocketed, and almost put those of us in the Federal and public service in a separate class. If we do not correct that kind of inequitable situation, which I am sure your testimony and the others' here this afternoon will address then we not only are we going to continue with these high deficits and interest rates, but there is going to be an equally high disinterest rate in public service.

Mr. **Keith**. Senator, it is very nice of you. You were the only person who wrote me at the time of the passage of that amendment of yours. Of all my 500,000 constituents, there were none.

Senator **Hollings**. I didn't get any letters either; don't worry.

STATEMENT OF HON. HASTINGS KEITH, FORMER CONGRESSMAN FROM THE STATE OF MASSACHUSETTS

ONE PERCENT ADD-ON PHENOMENON

Mr. KEITH. Senator, we are much maligned and, I think, much beloved because we have two different constituencies, of course. I think perhaps you have a copy before you of what the phenomenon was on that 1 percent add-on. I am dwelling on that just a bit because the removal of the 1 percent add-on was only done prospectively. Only future add-ons were stopped. All of the excesses that had been granted up to that time, 1976, we left in the pensions—and they are still there. In fact these excesses are being compounded and are a part of the present pension income.

For example, at the time that the 1 percent add-on was discontinued, there were $200 in my monthly pension that were left in above the cost of living. That amount has compounded so that it now amounts to about $300, maybe $400 each month. Because there were about 2½ million annuitants who had add-on increments, there are anywhere from $10 to $35 billion that is still going to be paid by the taxpayers just for that increment. The removal of the 1 percent add-on should have been done in accordance with the proposal that Paul Findley made to freeze the pensions until the cost of living caught up with the excess. Mine, as I said, was $200 ahead of the game, above the cost of living in 1976.

I have here a letter from a Federal retiree named Bill Howard,[1] who spells it out for us. His pension was just about the same as mine at that time (1976). He says in that letter that the kicker now accounts for approximately 10 percent of his current pension. His pension, I believe, is now about $3,310 a month. He has received $16,000 above the cost of living by reason of the increment that was left in there. He has received a total of $166,000 since the removal was passed. That is a sizable sum of money.

So, if there were some way to tackle that situation, it would be very much worth the committee's attention.

I am sorry that you have to go, Senator Hollings. I really am. That will just leave four of us. But I will quickly give you my testimony here.

REASONS FOR INVOLVEMENT IN PUBLIC PENSIONS

As a preface, I want to point out that both John Macy and I, who have formed a committee of former Federal employees and others, have spent a great deal of time and effort attempting to alert the public as to what is going on. We are joined on that committee by Elmer Staats, Joe Bartlett, Bryce Harlow, a lot of good former Federal employees who are concerned and willing to be a part of this effort of yours to bring the budget in balance and, in particular, to go after the pensions of which we are beneficiaries.

John Macy is here today and has been sharing this responsibility with me and is the chairman of this new committee.

We respect the civil service profession, enjoyed the work, and have a high regard for the vast army of civil servants who devote their lives to serving their country. There are three basic reasons for our involvement in the cause of commonsense in public pensions.

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[1] See p. 195.

One, we were involved in the legislative process by which the social security system and the civil service system evolved.

Two, we benefit from both systems in ways which were not intended by the original acts of Congress.

Three, both of us feel that the grossly generous treatment that we and, almost without exception, all other Federal retirees get is so costly that the solvency and even the security of the country is at stake.

There are two things that the Federal Government has primary responsibility for. I do not mean to be lecturing to you. I really should turn around and talk to our constituents here. They are a sound dollar and a strong defense. If we took care of those two things, we would not be here today addressing this problem.

COUNTRY CANNOT AFFORD PENSIONS

We believe further that this problem has the potential of tearing our society apart, of causing cutbacks in worthwhile projects for the truly poor. The country just cannot afford these pensions, these additional taxes and the additional borrowings which are required to meet these costs. These taxes and these borrowings only exacerbate inflation.

We believe that very few public employees at any and all levels of governments have any understanding of the cost of the pension benefits which they receive. Therefore, we have organized the National Committee for Public Employee Retirement Systems, and we call it PERS, P-E-R-S. It perhaps should be p-u-r-s-e. I am not speaking as the vice chairman of that committee but, rather, as an individual. However, my views are in all respects those of the committee's chairman, John Macy, who, I should say, is a former Chairman of the Civil Service Commission, a former president of public broadcasting, a former head of FEMA, and has written a book on public service.

FEDERAL WORK FORCE WILLING TO DO THEIR SHARE

We recognize that the budget problem is paramount and that this committee to be successful must have the support of the American people as a whole. We believe, further, that the vast majority of the Federal work force is willing to do their share, even as they did in the days of the Great Depression when their pay was cut—and, I believe, their pensions as well—right across the board. We have been concerned that there has been such a sustained and strident effort on the part of the major voice of the retirees, the National Association of Retired Federal Employees, NARFE. We believe that our committee, PERS, will be more responsible, less strident, and more balanced in its views.

Macy and I are strong advocates of social security. We believe the country as a whole needs this system and that we as Federal employees and retirees should be a part of it and pay our contribution to it. We do not want to dodge our responsibility and we do not want to be a part of any movement which, by its opposition to social security, threatens the system's ability to contribute to the stability and strength of our society and our nation.

RETIREMENT PLANS TOO LAVISH

Furthermore, we believe that the civil service and some of the other Federal retirement plans are so lavish, with other people's money, that eventually, unless there are far more radical changes than have been addressed thus far, they will cause budget problems that make those of this Congress look minuscule by comparison.

You are worried about balancing today's budget; you are concerned about adding another $100 billion to the debt and so are we. But the country already, right now, is hooked on a trillion dollars of debt that does not even show up in the official balance sheet. We have made pension commitments that we cannot keep any more than Chrysler can keep its commitments to its workers. We, the taxpayers, are already making pension payments with borrowed money; perhaps it should be called printed money.

So, Mr. Chairman, your most fertile field for harvesting is amongst the Federal retirement systems. I do not believe there is a single career employee, with 30 years of service, who retired during the years prior to 1975 who is not getting more money in retirement than he earned in salary. I have checked that. I do not see how it could be possible for anybody who retired prior to 1975 with 30 years of service, to be getting less in retirement than he earned in salary. I have got a letter here which I would like to read to you. The gentleman is here today. He first came to my attention back in 1975, when he wrote a letter to the Washington Post. By the way, his grandmother was a slave, but she taught him to save his money. He is a loyal and thoughtful American. He worked for the Treasury Department for 42 years. I believe he started when he was in high school. If he does not sound like a banker, I never heard one.

RAISES AND INFLATION

Here we go again, on raises and inflation. Mike Causey in the Federal Diary reports today in the Post, November 21 [1975], that another raise is in the works, due next March, for 2 million former civil service and military retirees. I am a civil service retiree, and I want to state that this news is not at all pleasing to me. There was an article in the paper a short time ago reporting an increase in personal income. It pointed out that the increase was in large measure attributable to raises granted Federal employees, active and retired, during the past year. Inflation is now a seemingly incurable economic disease. As soon as we begin to believe that we have it under some little control, these recurrent increased Federal payments made with short-term borrowed money rolled over and over, added to other worldwide economic distortions, help promote the continuing inflationary fevers. If new laws are needed to correct this chronic condition, they should be considered by Congress promptly, the election year ahead notwithstanding. If the country must endure more austerity for the time being in order to regain fiscal and economic equilibrium, then Federal employees both active and retired, civilian and military, ought to share the deprivations and burdens the same as the private sector of the economy, especially with the public debt soaring above the half trillion mark and heading straight up.

Maybe the lesson of New York is not altogether inapplicable, where increasing millions of borrowed money for current expenses was rolled over and over again, piling up an enormous unmanageable debt which ended up in disaster.

Imagine my surprise when I went out and visited this gentleman on the outskirts to find him living in a little house of Washington, gardening in the summertime and reading in the wintertime and once a year or two writing a letter. Today he handed me this:

RETIRED FEDERAL EMPLOYEE STATES HIS POSITION

Dear Hastings, when you testify before the Senate Budget Committee relative to the pension system, would you mind stating my position? I am a retired Federal employee. I retired in 1965 on an annuity of $4,760, which amounted to $395 per month. I now receive over $1,200 per month. I believe that the increases I have received over the years have exceeded the rate of inflation. I got back what I paid into the civil service retirement fund in less than a year. Since then, I have been receiving my annuity at the expense of the private sector of our economy. The employees of the private sector generally do not receive retirement benefits anywhere near the generosity which characterizes the Federal program. I think that no more cost-of-living increases granted the beneficiaries of the Federal retirement program should be allowed.

I also think the same restrictions should be applied to the military pension program. Charles L. Morris

I think that gentleman really deserves our thanks. I would be delighted if you greeted him today because he has inspired me. He is right here behind me, this fellow right here. I am very grateful to him.

Senator BOSCHWITZ. Thank you very much.

Mr. KEITH. Now, Mr. Chairman, I have almost said enough. It seems to me Charles Morris has said it all. I will dispense with that, but I will now describe a little bit in detail what the situation is.

COMPARATIVE FACTS OF EMPLOYEE PENSIONS

This information comes from the Joint Economic Committee report,[1] which was embargoed until November 9, 1980. Right after the election they released the report and nobody really read it, I am afraid.

CIVIL SERVICE RETIREES

Here is what the report says. Civil service retirees in 1980 1.7 million annuitants—received pensions totalling $14.7 billion, an average of $1,050 per month for the career civil service retiree, $725 per month for disabled employees, and about $425 per month for the surviving spouses. The total unfunded liabilities for civil service retirees were $469 billion. The unfunded liability is now in excess of $100,000 per participant.

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[1] See p. 194.

I might add that the automatic and full indexation of these benefits doubles the cost at least.

MILITARY RETIREMENT

Military retirement, which is noncontributory, covered in 1980 2.9 million persons in uniform, including reservists. I would point out that only about 12 percent of those 2.9 million ever stay the 20 years. So, you know, it is a waste as a recruiting tool. This average includes reservists, this average of $730. I might say that the average career officer now gets more than $1,700 per month, fully indexed. On top of that, he will get social security tax-free.

STATE AND LOCAL GOVERNMENT RETIREES

I almost can dispense with these statistics. I just could say that the 2.2 million people State and local governments collected $9 billion last year from the State systems.

SOCIAL SECURITY

The poor social security recipient got $338 per month in 1980. His widow got $310. The unfunded liabilities of the social security system, according to the consolidated balance sheet, are about the same as those for the entire Federal spectrum of pension plans.

PRIVATE SECTOR

The private sector does not get in total as much as all of the Federal retirees. In other words, 5 percent of the retired people in this country get more benefits than all of the retirees the private sector. It is an amazing and frightening statistic.

Senator **Boschwitz**. Would you say that again please?

Mr. **Keith**. Yes, in 1979 there were in the private sector 9 million beneficiaries who drew private-sector pensions. They received $15 billion in 1979, or an average of $213 per month per person. May I say, parenthetically that, of course there were lots of others who did not get any private sector pensions. But practically all of these beneficiaries drew social security. People with private-sector pensions generally receive much larger social security benefits than the average person, who draws only social security. This is just noted in passing.

PUBLIC SECTOR

In the public sector, the total pension of the military and the civil service is about $27 to $30 billion per year. So, it is quite evident that by comparison, the private sector does not do very well.

Senator **Boschwitz**. What is the number?

Mr. **Keith**. The number of people in the public sector?

Senator **Boschwitz**. Yes, retirees.

Mr. **Keith**. In the military there were 1.3 million annuitants last year. In the civil service there were 1.7 million annuitants last year. Of those 1.7 million annuitants, there were tremendous numbers of disability annuitants, about 343,000 out of the 1.7 million. If we had the same standards for disability in the private sector as we do in the public sector, we would solve the unemployment problem. It would be down to 4 percent.

Of course, if you had the same standards for retirement as far as age is concerned, you would have a shortage of employment, except it would cost about $450 billion for the private sector per year to carry a plan that would give the same protection, the same retirement benefits as the public sector has. That, of course, would price us out of world markets. We would find that we would be a nation of shopkeepers.

As it is now, we only have about 30 percent of our work force that is really in industry; 70 percent is in service industries.

UP TO CONGRESS TO DETERMINE BENEFITS

I do not think it is necessary for me to go on too much longer. I have got here a notice that was published that might be of some interest to you. Back in January 1, 1937, it was published in all the factories and shops of the country: "Beginning January 1, 1937, your employer will be compelled by law to deduct a certain amount from your wages every pay day." It finally concludes, "This is not a voluntary plan. Your employer must make the deduction. Regulations are published by the Social Security division. There is no guarantee that the funds thus collected will ever be returned to you. What happens to the money is up to each Congress. No benefits of any kind before 1942."

So, they were on notice that it is up to the Congress to determine the benefits.

AMOUNTS OF CIVIL SERVICE PENSION BENEFITS

I think, Mr. Chairman, that you have been very generous. My fellow panelists have, too. But I would like to just show you one or two charts. This is a chart showing the amounts of benefits that have been given since civil service pensions were started back in 1921 and how they have climbed each year. This shows the older annuitants. This shows the disability annuitants. and these are the widows, and these are the children.

But it is just frightening when you compare it to the other benefits in the private sector insofar as both numbers and amounts are concerned.

I have also been trying for some time to illustrate to the Secretary of the Treasury my concern about this problem. I have called and asked for an appointment. I have written him a letter, which I want to hand deliver. In that letter I say: Here are three checks totalling $3,107. They represent the monthly excesses in entitlements which have been sent to me in constantly increasing amounts over the last several years. Now, these are monthly excesses that I have been getting, and there is $3,107 that I am returning because it represents excesses.

The amounts have been arrived at by the following logic. One, cost-of-living adjustments since I retired: I cannot justify these adjustments because I was gainfully employed after I retired. Prudent Congressmen should have prohibited cost-of-living adjustments for those who simply changed jobs and were not really being denied any increased income resulting from inflation. My pension in 1973 was $1,560. My pension in 1981 was $3,419. This month it goes up about $300 or $400 more. The difference is $1,859.

My time in the military counted toward my civil service/congressional pension. The active duty time counted toward my reserve pension also.

Senator BOSCHWITZ. Your military pension?

Mr. KEITH. Yes, my military pension. I had 5 years and 10 months.

Senator BOSCHWITZ. In the service?

Mr. KEITH. In the service.

Senator BOSCHWITZ. Then the time in the Congress counted toward the military pension?

Mr. KEITH. No, the time in the military counted toward my Federal pension. So, I had 20 years of Federal service because I was in the military and because that time reflects my years of service., I had 5 years and 10 months of active duty. Therefore, I was entitled to an earlier Federal pension than would otherwise have been the case. It started at around $550; it is now $903. So, the second check is for $903.

Senator BOSCHWITZ. I did not understand that, Congressman. You get a congressional retirement check and you also get a veteran's check?

Mr. KEITH. Not a veteran's. A Reserve officer check.

Senator BOSCHWITZ. Oh, I see.

Mr. KEITH. I was a colonel in the Reserve before I came to Congress.

PENSION BASED ON COMBINATION OF MILITARY AND GOVERNMENT SERVICE

Senator EXON. Let me see if I cannot clarify this, if I could, Congressman Keith and Mr. Chairman. As I understand it, after you have been in government service, either in the Congress or if you work for the bureaucracy, you pay in and you cannot become eligible for any kind of retirement until you have been here for 5 years. I think that is the basic, right, 5 years?

Mr. KEITH. That is correct.

Senator EXON. After you have been here 5 years, then you can add on the number of years on top of that that you served in the Army, Navy, Marine Corps, Air Force. So, therefore, if you were here for 5 years and then had 5 years of service, that would be the equivalent, would it not, of 10 years on which your basis of your pension that you receive from the Government. Is that right? The combination of the two?

Mr. KEITH. That is correct.

Senator EXON. In your case, I just assume that you were here in the Congress for 15 years and then you had 5 years on top of that; so, that made 20. Is that right?

Mr. KEITH. No, not quite. I was here 14 years. I then was qualified for retirement after I had a few months of additional civil service.

Senator EXON. So, you had 14 here and other service plus 5. You got to 20, is that right?

Mr. KEITH. That is correct.

Senator EXON. I think that is what you were trying to get at, Mr. Chairman.

Mr. KEITH. So, the 5 years and 10 months that I served in the military provided me with a military pension. The time was also counted, independently of that, toward my civil service pension. Really, it is a double dip. In this case it was military.

I also was covered for social security. That is the third check.

In 1980 I became 65 and drew social security. It is now $691 a month. It is customary to integrate social security in the private sector. It enables the employer to provide larger benefits for those who retire early. This should be taken into consideration when establishing reasonable replacement ratios, that is, final and total pension income should recognize that there is a social security program.

I believe that the civil servant should pay his share to and get his share from social security. I am therefore saying that my civil service pension, when I finally retired and became eligible for social security, should have been offset by 50 percent of the social security benefit. Hence, the third check reflects one-half of my social security check; hence, the $345.

I do not intend to send further checks. I will continue to speak out on this issue using the newly established Committee on Public Employee Pension Systems. For your information, I am enclosing a list of those who have indicated their desire to help in restoring commonsense to Federal pensions.

SOCIAL SECURITY IS A GRATUITOUS ADD-ON FOR MILITARY RETIREES

There is one other comment I would like to make, and I appreciate the patience of my colleagues on the panel. But I think I should point out a very obvious thing concerning the military. Social security is a gratuitous add-on for military retirees at age 65. If you wanted to save some money, social security should be integrated.

I tried to convey to Secretary Weinberger my concern about this. I have not had any more luck with him than I did with Secretary Regan.

Senator BOSCHWITZ. Thank you very much, Congressman. Senator?

Senator EXON. I have no questions. I just want to join my colleague in thanking you for coming here, Congressman. It is very, very enlightening testimony and very helpful to us. Thank you.

Senator BOSCHWITZ. Let me ask just one question. How many people belong to this organization?

Mr. KEITH. I wish I could say my name was McNamara and I'm the leader of the band, but we are very few in number but the finest in the land. We just qot going a couple of weeks ago. We have about 40. There are very few Members of Congress because they are not retiring. They are not in a position to play an active role. Dick Bolling was asked, and we do have his support.

Senator BOSCHWITZ. I congratulate you, Congressman, on your efforts. You are certainly bringing to our attention in a very forceful way the problems that surround retirement of Federal employees. I hear about this all the time from my constituents. They understand the differences that exist. I do not think they understand the scope of it, as you have so well outlined here today. I congratulate you for taking a lead in this. I congratulate your friends who are with you who have the forthrightness to speak out, at some cost to yourself, I am sure. Certainly it is a gutsy thing to do. I appreciate it. I think I speak also for the other members of this committee and Congress. We will see that the word that you have given us is spread so that others are aware of the scope of the obligations that we have, the scope of the payments, I think, are well known. But the feelings of a developing group within the group of Federal—I will have to get my brother-in-law to join you. I am not sure that he will. But——

Mr. **Keith**. You would be surprised at the numbers who are sympathetic to what we are doing among the Federal employees and retirees. They know reform has to come. I am sure they will respect you for what you do. They will not respect you as much if you overlook the problem.

Senator **Boschwitz**. Well, Congressman, I will have the courage. I hope that 51 of my colleagues also have the courage and do join me. We would like to get together with you individually and singly to dig a little deeper into the ways we can reasonably control the Federal employee pensions in all directions.

PREPARED STATEMENT OF HON. HASTINGS KEITH, FORMER CONGRESSMAN FROM THE STATE OF MASSACHUSETTS

Mr. Chairman, as a preface to these remarks I want to point out that both John Macy and I have dedicated most of our lives to public service. We respect the profession, enjoyed the work and have high regard for the vast army of civil servants who devote their lives to serving their country. There are three basic reasons for our involvement in the cause of common sense in public pensions.

1. We were involved in the legislative process by which the social security system and the civil service system evolved.
2. We benefit from both systems in ways which were not intended by the original acts of Congress.
3. Finally, both of us feel that the grossly generous treatment that we, and, almost without exception, all other federal retirees get is so costly that the solvency and even the security of the country is a stake.

COUNTRY CANNOT AFFORD PENSIONS

We believe further that this problem has the potential of tearing our society apart—of causing cutbacks of worthwhile projects for the truly poor. The country just can't afford these pensions, these additional takes and the additional borrowings which are required to meet these costs. These taxes and these borrowings exacerbate the very inflation it seeks to abate.

We believe that very few public employees—at any and all levels of governments—have any understanding of the cost of the pension benefits which they receive. Therefore, we have organized the National Committee for Public Employee Retirement Systems (PERS]. I am not speaking as the Vice Chairman of that committee, but rather as an individual. However, my views are in all respects those of the committee's Chairman John Macy, who has read this statement and concurs in its content.

FEDERAL WORK FORCE WILLING TO DO THEIR SHARE

We recognize that the budget problem is paramount and that this committee must, to be successful, have the support of the American people as a whole. We believe, further, that the vast majority of the federal work-force is willing to do their share—even as they did in the days of the great depression when their pay was cut (and I believe pensions as well) across the board. We have been concerned that there has been such a sustained and strident effort on the part of the major voice of the retirees, the National Association of Retired Federal Employees (NARFE). We believe that our committee, PERS, will be more responsible, less strident, and more balanced in its views.

Macy and I are strong advocates of social security. We believe the country as a whole needs this system and that we federal employees and retirees should be a part of it and pay our contribution to it. We don't want to dodge our responsibility and we don't want to be a part of any movement which, by its opposition to social security, threatens the system's abiliity to contribute to the stability and strength of our society and our nation.

RETIREMENT PLANS TOO LAVISH

Furthermore, we believe that the civbil service and some of the other federal retirement plans are so lavish (with other people's money) that eventually, unless there are far more radical changes than have been addressed thus far, they will cause budget problems that make those of this congress look minuscule by comparison.

You are worried about balancing today's budget, you are concerned about adding another hundred billion dollars to the debt. And so are we. But the country already, right now, is hooked on a trillion dollars of debt that doesn't even show up in the official balance sheet. We have made pension commitments that we cannot keep any more than Chrysler can keep its commitments to its workers. We, the taxpayers, are already making pension payments with borrowed money—perhaps it should be called printed money.

And so, Mr. Chairman, your most fertile field for harvesting is amongst the federal retirement systems. I don's believe there is a single career employee (with 30 years of service) who retired during the years prior to 1975 who is not getting more money in retirement than he earned in salary. I am not saying he can't use it. I am saying that we—both the federal retiree/employee and the public whom he serves—can't afford it. I am saying that it is bad for ur nation's morale—and morality—for the country to go further into debt to pay these kinds of pensions. The Administration is right in proposing the freezes on federal pensions—but they are not getting deeply enough into the pension problems to know where the windfall benefits are, and they appear not to be willing to listen. I have written and phoned Mr. Stockman and offered out services and those of the people who worked on the two pension committees on which I have served—all to no avail.

PENSION INDEXATION CAN BE EXCESSIVE AND INFLATIONARY

Finally, in order to entice the Secretary of the Treasury to exchange ideas on pension reform and to demonstrate the flaws in the pension system, I offered to turn back to the Treasury three checks totalling $3,107. These three checks reflect the monthly pension excesses that are above what I believe my three pensions should be. For the past month I have talked with Secretary Regan's staff hoping to find a time suitable to him when I could talk either with him or with one of his Assistant Secretaries. They apparently are not interested. I am glad your committee has invited me to testify in particular on:

1. Indexation of federal retirement programs as they are affected by the Consumer Price Index; and
2. alternatives to current spending requirements which would increase controllability (of the budget).

As to the indexation, generally speaking it can be said that when indexation by the federal government goes beyond the minimum pension necessary to sustain a retiree and his spouse on a standard of living above that of the average wage earner, it is excessive and inflationary. Anyone who can count on pension indexation at government expense above that amount does not have sufficient incentive to save, and, in fact, has an incentive to spend. These are fuels which rev up the inflation engine. To me it is just that simple—social security should provide such an income. It (social security) should serve as a platform on which an individual can build, by himself or in conjunction with his employer, his own savings program either for retirement or as a supplement to social security.

The "much maligned" Hollings-Chiles amendment of 1976 is an example of how the federal retirement plans are affected by the CPI, and because the amendment was not further amended on the floor, there are still 20 or 30 billion dollars (depending on the rate of inflation) of further pension liabilities that will eventually become line items in the budget.

Mr. Chairman, I have with me a summary sheet of pertinent facts which outline the variations in the features of the nationwide pension systems. I am suggesting that a study of it—even a scanning of it—tells you much more than is necessary to see where your search of savings in entitlement should go.

Thank you for allowing me to appear on today's panel.

PUBLIC EMPLOYEE PENSIONS

HIGHLIGHTS OF PERTINENT COMPARATIVE FACTS

The following facts are largely drawn from three sources—(1) A Joint Economic Committee Report, October 1980; (2) the Federal Retirement Plan Reporting Act, prepared by the Pension Task Force of the House of Representatives, and (3) the U.S. Budget Appendix for Fiscal Year 1982.

The Joint Economic Committee's report emphasizes the social and economic aspects of the federal pension systems. The Reporting Act reveals that actuarial liabilities for all federal retirement plans were just under a trillion dollars in the year 1980. The nation's Consolidated Financial Statement generally confirms the facts outlined below, and further reveals that "off the books" liabilities for federal pensioners are about $1,000 billion. This will eventually have to be budgeted to meet future pension payments as they become due.

CIVIL SERVICE RETIREES

In fiscal year 1980, 1.7 million annuitants received pensions totalling $14.7 billion annually—an average of $1,050 per month for the career civil service retiree, $725 per month for disabled employees, and about $425 per month for the surviving spouses. The total unfunded liabilities for civil service retirees were $469.5 billion as of September 30, 1980. This unfunded liability averaged more than $100,000 per civil service participant.

Note.—The automatic and full indexation of these pension benefits, generally speaking, doubles the cost to the taxpayer.

MILITARY RETIREMENT SYSTEM

This system, which is non-contributory, covered in 1980 2.9 million persons in uniform (including reservists) and paid some $11.9 billion to 1.3 million annuitants—an average of $730 per month per recipient. This average includes reservists and surviving spouses of both the regular and the reserve forces. Unfunded liabilities averaged $149,000 per participant, both active and retired, and totalled $431 billion:

Note.—Only about 12-15 percent of the military stay the 20 years to get these costly pensions. Because military personnel are covered by Social Security those that do retire get much more "take home pay" in retirement than they drew while in the service.

FOREIGN SERVICE

In fiscal year 1980 the system paid almost $20,000 to the average foreign service retiree. Small wonder that the unfunded liability was $4,989.5 million.

STATE AND LOCAL GOVERNMENT RETIREES

In fiscal year 1980, 2.2 million state and local government retirees and their survivors collected $9.6 billion, and average of $364 per month. About 70 percent of them are covered by Social Security. Unfunded liabilities are, according to the House Pension Task Force, estimated to be about $200 billion.

SOCIAL SECURITY (OASDI)

In 1980, 33.3 million retired workers got an average Social Security pension of $338 per month. The widow or widower's benefit averaged $310 per month. The unfunded liabilities are a trillion dollars—approximately the same magnitude as for the total of all federal plans but for nearly twenty times as many active and retired participants.

PRIVATE SECTOR

In 1979, 9 million beneficiaries who drew private sector pensions received $15 billion, an average of $213 per month. In addition, practically all of them drew Social Security.

Note.—People with private sector pensions generally receive much larger Social Security benefits than the average person who draws only Social Security.

Further note.—There is relatively little automatic indexation in private sector pensions. (The Social Security portion is, of course, fully indexed.)

DISABILITIES

As of fiscal year 1980, there were 343,251 former federal employees who were drawing disability pensions (i.e. 27.5 percent of all federal retirees). If the private sector had the same lax eligibility requirement for disability, there would be 4.6 million people on disability pensions, thereby opening up enough jobs to bring the nation's unemployed down to 4 percent.

If, in addition, the private sector employees could retire at 55 or 60, as is the case with the federal employees, there would be virtually no unemployment—but at what a cost. The cost for such generous retirement and disability programs would be at least $400 billion annually, an obvious impossible burden for our economy.

FEDERAL/SOCIAL SECURITY PLANS

Several federal agencies have retirement plans that are integrated with Social Security. One of them, the TVA, could serve as a model for other federal agencies. It has a very generous formula, provides for actuarially sound early retirements, and only requires 11.5 percent of payroll. In addition, the employer and employees each pay 5.35 percent of salary for Social Security. The TVA plan has virtually no unfunded liability.

It is interesting to note that the $27 billion paid in 1980 to federal retirees, military and civilian, is almost double the $15 billion paid out by private plans to retirees in the private sector. That is, some 3 million federal annuitants drew nearly twice as much from their employer as did the 9 million private sector retirees.

CINCINNATI, OHIO, *January 1, 1981.*

Mr. HASTINGS KEITH,
Glenbrook Terrace
Washington, D.C.

DEAR MR. KEITH: In connection with the article that you are writing, you are advised that my own Federal retirement benefits to date since I retired mid-1975 are as follows:

Monthly annuity received			Annual annuity	
From	To	Amount	Year	Amount
July 2, 1975	Aug. 1, 1975	$2,007		
Aug. 1, 1975	Apr. 1, 1976	2,109	1975	$12,552
Apr. 1, 1976	Apr. 1, 1977	2,223	1976	26,334
Apr. 1, 1977	Oct. 1, 1977	2,330	1977	27,939
Oct. 1, 1977	Apr. 1, 1978	2,430	1978	30,048
Apr. 1, 1978	Oct. 1, 1978	2,488	1979	32,799
Oct. 1, 1978	Apr. 1, 1979	2,610	1980	37,065
Apr. 1, 1979	Oct. 1, 1979	2,712		
Oct. 1, 1979	Apr. 1, 1980	2,899		
Apr. 1, 1980	Oct. 1, 1980	3,073		
Oct. 1, 1980	Apr. 1, 1981	3,310		
			5½-yr total	166,737

There are two reasons government workers' retirement benefits have been more than they might have been:

(1) A retroactive cost-of-living adjustment is granted upon retirement. In my case, retirement on July 2, 1975 was then increased 7.3 percent for the Jan. 1, 1975 COL

and this "look-back" adjustment accounts for $11,344 I have received thus far. ($166,737+1.073=$155,393)

(2) The other reason is the so-called "1 percent kicker" that was repealed in 1976 with your help, but not retroactively. My own annuity benefits from these prerepeal adjustments (intended to compensate for delayed COLs) were:

Date of 1 percent kicker	Amount	1 percent of that subsequently received
Jan. 1, 1975	$1,650.86	$166,737+1.01.
Aug. 1, 1975	1,630.99	164,730+1.01.
Apr. 1, 1976	1,463.94	147,858+1.01.
Total	4,745.99	2.846 percent of amount received thus far.

Thus, due to an initial retroactive COL and three 1-percent kickers in my case, my 1981 annuity will be approximately 10 percent more than it otherwise would have been. These two factors account for $16,089.79 of the $166,737 that I have received during the first 5½ years of my retirement.

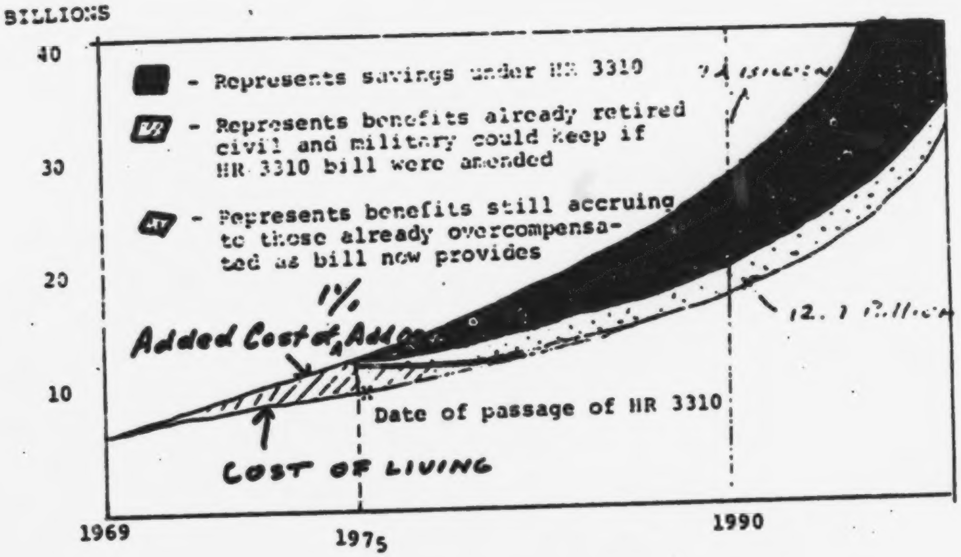
As of this date, the present value of my annuity is calculated at $1,035,710. This assumes my life expectancy of 241 months at the current $3,310 monthly for $797,710, and an additional 119 months expectancy of my surviving spouse at her rate of $2,000 monthly amounting to $238,000. Note that these calculations are not discounted for Present Value using projected interest rates because of the automatic cost-of-living adjustments which will equal or exceed the projection.

WILLIAM D. HOWARD.

Assumptions: (1) Assumes 1,000,000 military and, 1,300,000 civil service retirees and a total present cost in 1975 of $13.1 billion; (2) assumes no additional pensioners; (3) an average annuitant life expectancy of only 15 years; (4) it further assumes that 75 percent of present retirees are now married—and that 72 percent of their spouses will survive them; (5) finally, it assumes the surviving spouse will live 9.9 years.

These assumptions as to life expectancy and the computation as to costs were computed for me by Robert Myers, retired chief actuary of the Social Security Administration.

TOTAL EXPENDITURES FOR FEDERAL PENSIONS



This chart shows the nature and extent of the savings that will accrue if H.R. 3310 passes—

In its present form—assuming a ½ of 1 percent per month inflation—H.R. 3310 will save over 15 years about $72 billion. (This assumes leaving accumulated percentage points of the add-ons of present retirees as they are now.)

If the pension bill were amended so that the present pensions, with their existing add-ons, were stabilized until future CPI increases catch up with it, an additional $12.7 billion would be saved over the next 15 years.

FEDERAL PENSION FACTS

[1980 plan year]

Plan	Participants		Assets (millions)	Present value of accrued benefits less assets (millions)	Unfunded actuarial liability (millions)	Unfunded actuarial liability per active participant
	Active	Retired, survivors, deferred vested				
Civil Service	2,700,000	1,929,000	$72,980	$357,300	$469,500	$173,889
Military	2,888,000	1,332,000	0	348,900	431,100	49,273
Foreign Service	9,401	7,153	673	3,692	4,990	530,795
Federal Reserve Board and Bank (2 plans)	26,035	9,571	850	171	340	13,041
Nonappropriated fund plans for civilian employees of military exchanges (7 plans)	59,065	14,874	762	51	591	10,013
Farm credit district plans (11 reporting districts)	12,812	2,446	156	26	64	4,980
Federal judiciary and U.S. Tax Court plans (includes survivors plants; 4 plans total)	659	412	44	216	144	217,906
National Oceanic and Atmospheric Administration Corps plan	365	156	0	83	118	323,288
Comptroller General plan	1	2	0	1	1	1,006,000
Total [1]	5,696,338	3,295,614	75,465	710,046	906,848	59,198

[1] Excludes 5 plans not reporting on time (U.S. Coast Guard, U.S. Public Health Service, Tennessee Valley Authority, Federal Home Loan Mortgage Corporation, Columbia, S.C. Farm Credit District) and 5 defined contribution plans maintained by Farm Credit Districts.

Senator BOSCHWITZ. We should get on now to Ms. Campbell. We thank you and Ms. Campbell for being so patient, also Dr. Bosworth. If you would give your testimony, we would appreciate it.

STATEMENT OF RITA RICARDO-CAMPBELL, SENIOR FELLOW, THE HOOVER INSTITUTION, STANFORD UNIVERSITY

Dr. RICARDO-CAMPBELL. Thank you. I do use professionally the name of Ricardo-Campbell because I am descended from a very famous economist and wrote under my maiden name of Ricardo. So, I use that.

I am going to skip all the statistics or at least most of them and just draw the conclusions from the testimony because the time is late. I do not think anybody wants to hear as many statistics as there are in the written testimony.

I was asked today to speak about the entitlement programs and the fact that 75 percent of the budget approximately is not controllable. Among the entitlements you heard about from Secretary Schweiker are social security, railroad retirement, and Federal retired employees. My friend, Hastings Keith, has covered very well that elite aged group, that is, anybody who has worked for the Federal Government either in military or civil service. I am limiting myself similarly to social security and medical care. I will say a few words about Federal employment. I would like to talk a little bit longer about medicare and medicaid because I have just written a book that will be published by the University of North Carolina called: "The Economics and Politics of Health." It is available March 21 and I will see that you get one, sir.

Senator **Boschwitz**. Yes, we would like to.

POPULAR MEANING OF ENTITLEMENT HAS MORAL OVERTONES

Dr. **Ricardo-Campbell**. I would like to make a kind of philosophical remark, about a word which I do not think people in Congress always understand. These programs are labeled entitlement programs. It is a very unfortunate use of the word "entitlement". The Congressional Budget Office, this committee, and people on the Hill use the word correctly in its legalistic sense. That is the benefits and the open-ended manner of their increase is set by the law. The media, however, use the word entitlement without confining it to its legal meaning. Nor do they clarify to the public how the Federal budget uses the word entitlement. Thus, the popular meaning of entitlement has moral overtones. That is the meaning that prevails in public discussion. Webster's dictionary correctly defines the verb "entitle" as "to furnish with proper grounds for seeking or claiming something." That is precisely what the laws governing these benefits do. However, colloquial usage has been transforming entitled to mean "to have a moral right," not only a legal or statutory right.

Many people will state in reference to an individual who gets what he perceives to be a luxury that "you are entitled," meaning that it is your due because of past actions, hard work, position, or other nonlegal factor. I think this needs clarification, and I hope that this committee attempts to make some type of clarification.

AGED CONSISTS OF TWO GROUPS

Another matter I would like to address is not in the written testimony but comes to mind after listening to other people testifying. Nobody present has pointed out that the aged are really two groups in our society. There are the young aged and the old aged. The old aged are still relatively poor. These are people 80 years and older, primarily aged widows because women live longer than men, but whose social security benefits and pension rights, if they have any, are based upon earnings of the 1940's and 1950's. The young aged—and I refuse to put 62 to 65 in that; I will call it 65 through 75, approaching 80—these people not only are not on the average poor; they are better off than the younger heads of households in this country. They are better off both income-wise and asset-wise. Much recent data is proving this point that I have been trying to make for several years.

The young people, because they perceive and know that they are not as relatively well off, do not feel that they should have children or at least do not have them in the numbers that they have had in the past. That is one of the reasons our birth rate is declining.

I do not know whether the retired have any moral right to federally paid benefits that rise with the cost of living in those periods during which the real wages of the workers, most of whom are younger, are falling. Workers pay taxes out of those earnings to pay for the benefits to the aged. If society is going to reproduce itself, I think that the younger people need a better shake than what they are getting in the United States and what they will be getting in the next 20 years unless the program is changed.

BENEFIT INCREASES GREATER THAN WAGE INCREASES

Not until 1975 was the first automatic increase in social security benefits made as a result of tying them to the Consumer Price Index. Therefore, future increases in benefits can be changed, in my opinion. I am not representing the administration. In every year from 1970 on, benefit increases have been greater than wage increases.

In 1979, average weekly earnings in private, non-agricultural industry fell by 3.1 percent; in 1980, by 5.8 percent; and in 1981 by 1.5 percent. We are transferring real income from our young people to the older people of the country.

If you look at per capita income, of course, the younger people are not as well off because they have more children in the family to support. The Social Security Bulletin, the December 1981 issue, states: "The aged as a group are no longer disproportionately poor compared with the adult population as a whole."

Two economists, one at Hoover Institution and one at Stanford University, have estimated the average per capita disposable income in 1978 of those persons 65 years and over and found it to be $4,450 as compared with that of the entire population at $3,412.

I would say that that comparison sums up the statistics in one sentence as to what is occurring in the United States.

SOCIAL INSURANCE IMPLIES TWO CRITERIA

Social insurance, as social security is called, really implies two criteria: Adequacy of benefits and individual equity. Social security benefits were never meant to be the only source of income upon retirement. It was part of a "stool with three legs," where you have savings and you have private pension plans. And I agree—I am sorry Mr. Hollings is not here—that older people do like to work. They prefer earnings as the fourth leg of the stool. Encourage older people to work.

WAYS TO REDUCE SOCIAL SECURITY EXPENDITURES

I refer briefly to the appendix to my testimony that illustrates one way of gradually reducing benefits from age 62 to age 67 with the latter age drawing 100 percent of the full benefit. Obviously, if you want to reduce social security expenditures, you can reduce them in many ways. One of them is to slow the rate of increase in benefits. Another is to have fewer people receiving the benefits. It may be possible to induce people to continue on working. Unfortunately, the downward trend in the number of men working is continuing. Only 18.5 percent of men today are working at age 65, and that is a drop-off from last year.

Senator **Boschwitz**. Is that figure in here, too?

Dr. Ricardo-Campbell. Yes, sir, it is.

I have made several proposals over the years. One for which I have long stood is to increase social security benefits by the lower of the rise in the cost-of-living index or the wage index. I still think that is a very good, long-run approach. But I think the budget is in more trouble—and I am an economist—than when I originally made that proposal. I, therefore, would urge this committee to at least consider the fact that it is only 7 years since benefits have been tied to the Consumer Price Index. You might go back to the ad hoc situation of increasing benefits when the economy warrants it. This is a possibility in my mind. It does not have to be done. In fact, I would be happy if anything were done to break the 1-to-1 percentage rise tie that we have now got. Every time that you have an inflation of 1 percent, once you hit the trigger of 3 percent, you have an increase in expenditures for the retirement plans alone of $2 billion a year. This is an almost unbelievable situation.

Senator Boschwitz. I agree. I am a little bit skeptical about what to do. When it was attached, as you know, to the CPI, because the CPI was rising slowly at that time and also because the social security system was being used as a political tool and the——

Dr. Ricardo-Campbell. In 1972 they had increased the benefits by 20 percent and you wanted to stop it.

I am only saying to do something. I do not know which one is the ideal solution. I like Feldstein's proposal to cut back the rise by 2 percent. There are a lot of proposals out in the ball park. But I think something has to be done.

I am not going to talk much about the civil service annuitants except to say that the high level of those benefits has encouraged 75 percent of Federal workers between the ages of 54 to 60 years to retire. These are prime working years. They are taking other jobs.

POSTPONE MILITARY RETIREMENT PAY

In answer to a Congressman who is now not here, Mr. Exon, the military can retire after 20 years in the service, so, there are many that retire at age 40 or 42. Then they immediately start collecting retirement pay. I would like to see that retirement pay entitlement postponed to some age a little closer to normal retirement, say age 60. This, to me, would make more sense than to permit young people—I remember when I was first teaching at Tufts University when I had a class full of 40-year-olds collecting their military retirement pay and preparing for a new career for the next 25 years.

Senator Boschwitz. Have you seen any studies on whether or not that would restrict the ability to recruit people into the service?

Dr. Ricardo-Campbell. I was on the White House Fellows regional screen in San Francisco this past weekend and they had several military applicants. The younger military would be much happier if they would get a little earlier rewards and a little less later on. It is when you have children that are going to college that you need income. It is not when you retire that you need it so much. They were not averse to later entitlement to pensions based on military service.

TREAT CIVIL SERVICE PENSIONS LIKE PRIVATE PENSIONS

The administration has recommended that part of the social security tax, the 1.3 percent that supports medicare, be paid by Federal civil servants. I would integrate civil service pensions and treat them like private pensions. The 7 percent that is paid by employees does not support them. My paper addresses to that fact.

I would permit a Federal employee to deduct from income tax the 7 percent that he pays in to the civil service retirement fund, just as I deduct a percentage that I pay in to TIAA. Under many private pension plans benefits are partially offset by social security benefits. This, I believe, is very similar to the Tennessee Valley Authority, the TVA, integrated plan. It makes sense to me that you should have government workers under social security and that their pension should be along the lines of private pensions.

HOSPITAL CARE COSTS

I would like just briefly, if I may, to speak to health. I will just try to hit a few highlights.

Secretary Schweiker has proposed a 2-percent cut in reimbursement of hospital care costs. I agree with that. I think I would urge, however, at the same time that you require—some States are already beginning to require—or in some way induce the States to require that hospitals keep accounts like any other business firm does. You cannot usually look at a hospital bill and make any sense out of it. There is no relationship to the services you receive and the prices that are on it. Often the bill is not itemized. You cut down hospital days utilization. Then the hospital has more beds that are empty and are not earning any money. So, they load them onto their overhead to be paid by medicare.

I do not have much faith in the 2-percent cut. All I do know is that something has to be done about accounting by hospitals, and the consumer, the public has to be educated to understand for what they are paying or at least be interested in for what they are paying, so that they are not cheated to the degree that maybe some are now.

There are at least four different prices of health care items and there are cross-subsidies all over the lot. What I am arguing for is that it is made clear to the public what they are paying for.

I do not know to what extent I should take the time to read my written testimony.

Senator BOSCHWITZ. Without objection, your prepared statement will be inserted.

Dr. RICARDO-CAMPBELL. The Federal Government's cost of providing health care under medicare and medicaid has been growing rapidly, not because the benefits are indexed to the CPI, but because of the rising utilization rates, the prices of medical care and the increasingly complex and costly technology that saves life.

The administration suggested a $1 copayment for poor persons. I really do not think that is wrong. I think that it would be of some help in restraining use of medical care for minor ills. Medicaid now pays 100 percent of the bill.

My book points out that there is not one medical care market but there are multimarkets. If you devise legislation to fit emergency medical care, which is a very small amount of medical care, you get an entirely different type of legislation than if you think of what is usually medical care. It is primarily treatment of chronic disease and not of emergency medical care.

Senator BOSCHWITZ. Ms. Campbell, I will carefully read your testimony. I will see to it that the other members are made aware of it as well; I would like to be in touch with you. Perhaps you can——

HMO'S DO NOT CONTAIN COSTS OF MEDICAL CARE

Dr. RICARDO-CAMPBELL. Could I say one word on HMO's? It is not in the testimony. That is why I would like to say it. It is not there.

Senator BOSCHWITZ. HMO's are a big thing in my home State of out in Minnesota.

Dr. RICARDO-CAMPBELL. Well, a big thing out in California, too.

Let me explain what I wanted to say. It has been spread around the Hill and within the administration that HMO's contain the costs of medical care. This is rather firmly believed, that HMO's mean competition. I say flatly, and I think I can prove it, that HMO's do not contain the costs of medical care for society. They contain the costs of medical care for the particular HMO in question.

In Los Angeles, in San Francisco, in Seattle, Puget Sound, and those areas, there are a very high percentage of people enrolled in HMO's. They also have about the highest prices in the country.

The only place in the country—and you made me think of this, sir, when you mentioned Minnesota—that has shown that prices have risen somewhat less than the CPI are the Twin Cities, St. Paul and Minneapolis. Not until yesterday did I find out why. It has always puzzled me, knowing the market penetration in other areas. I found out that since 1974 HHS, although at that time it was HEW, had been having performed continual (a $3 million annual contract in 1981) utilization reviews among a majority of the fee-for-service physicians. This gives an entirely different picture. A large group of providers under cost review supported out of Federal contract money agree to hold down costs. That made sense to me because nowhere else where the growth of the HMO's has been as great have the prices been retained.

In fact, at Stanford University, where we have several HMO plans, which one do you think has the highest per capita charge? It is not Blue Cross-Blue Shield. It is one of the new HMO's.

I would like to say that my book speaks to these issues. I actually prefer what is known as the cafeteria approach of benefits. That is, the individual employee can select the type of benefits that suits them the best.

I believe that competition means advertising of pr:ices. I was delighted to see in Newsweek an ad by a large drug company aimed directly to the consumer. I will be very unhappy if FTC is restrained in antitrust action against health care providers.

I could go on. Competition does not mean protection through regulation of a few providers and that is what I would like to get over. Thank you.

Senator **Boschwitz**. Thank you very much, Dr. Ricardo-Campbell. I would like to be sure I have——

Dr. **Ricardo-Campbell**. I will leave you with this if you want. I have not got the book yet but——

Senator **Boschwitz**. I do not need that. I need your telephone number so I can call you.

We will recess for 1 minute.

[Recess taken.]

PREPARED STATEMENT OF RITA RICARDO-CAMPBELL, SENIOR FELLOW, THE HOOVER INSTITUTION, STANFORD UNIVERSITY

Today I have been asked to address the problems encompassed within the U.S. Budget in respect to its controllability in relation to the rising large expenditures of the so-called entitlement programs. These programs are labeled "relatively uncontrollable under present law;" and the President's Budget, fiscal year 1983, estimates these payments to individuals in billions of dollars as follows:

Social Security and railroad retirement	$175.6
Federal employees' retirement & Insurance (of which $16.6 billion is military retired pay and $32.1 billion, other)	48.7
Unemployment Assistance	22.7
Medical Care	76.0
Public Assistance and related programs	21.1
All Other (my classification)	10.9
Total	$354.9

Under the relatively uncontrollable heading are also net interest payments estimated at $96.8 billion and committed outlays from prior-year contracts and obligations of $129.7 billion. If to these, some smaller expenditure classifications are added, the 1983 estimate of the relatively uncontrollable amount in the Administration's Budget is $585.5 billion, or 77.3 percent of the total Budget as compared with 23.8 percent considered to be controllable. The precise figures can change as under the Congressional Budget Office's assumptions, but the problem that only about one-fourth of the Budget is believed to be controllable remains. The controllable portion is about $180 billion, of which $46.3 billion are outlays for civilian programs and the remainder for defense. Even if one believes that defense expenditures can be cut somewhat, on the theory that there is always some "water" in all large budgets, it is obvious that any real, meaningful decrease in outlays and the anticipated deficit of over $90 billion will have to stem from curtailment of those items labeled "relatively uncontrollable under present law" that make up three-fourths of the Budget.

My statement concerns expenditures for Social Security, railroad retirement and federal employees retirement benefits, and the Medicare and Medicaid programs. All of these are usually labeled "entitlement programs." This is an unfortunate choice of words. The Budget uses "entitlement" in its legalistic sense: that is, the benefits and the open-ended manner of their increases have been set by law.

The media, however, uses the word "entitlement" without confining it to its legal meaning, nor do they clarify how the Federal Budget uses the word. Thus, the popular meaning of entitlement, which has moral overtones, prevails in public discussions. Webster's Dictionary correctly defines the verb "entitle" as "to furnish with proper grounds for seeking or claiming something." That is precisely what the laws governing these benefits do. However, colloquial usage has been transforming "entitled" to mean to have a moral right, not only a legal or statutory right to a benefit. Many people state in reference to an individual who gets what he perceives to be a luxury that "you are entitled" meaning that "it is your due" because of past actions, hard work, position, or other non-legal factor. For example, The American Heritage Dictionary of the English Language, (Wm. Morris, ed., Boston, 1969) defines the verb "entitle" in its second meaning, simply to give (one) a right to do or have something;" and only in its fourth listed meaning "to give (one) a legal right to claim something." Thus, it is unfortunate that the U.S. Budget continues to use, no matter how correct the usage is, the word "entitlement" to describe these benefits.

Another general point is that the aged are not homogenous but can be divided into the "young-old" and "old-old" in respect to both income and health. The young-old, ages 62 through 75 clearly have on the average, higher incomes, more assets and better health than those individuals over 75 years. Among the latter are many who have Social Security benefits that depend on the low earnings of the 1940s and 1950s, fewer who have private pensions and, on the average, they are less well than persons 62 through 75 years.

It can be questioned whether those who are retired have a moral right to federally paid benefits that rise with the cost-of-living in those periods when inflation increases more than the real wages of the workers who pay taxes out of which the benefit payments are made. Not until 1975 was the first automatic increase in Social Security benefits made as a result of tying them to the Consumer Price Index (CPI). The June, 1981 increase was the seventh overall automatic increase. In every year from 1970 on, benefit increases have been greater than the average wage increase. In 1979, average weekly earnings in private, non-agricultural industry fell in real terms by 3.1 percent; in 1980, by 5.8 percent and in 1981, by 1.5 percent, while Social Security benefits, in real terms, remained constant. Real income is being transferred from young to old.

The average (mean) income of families (many of whom have more than one worker) where the "head of household" is 18 to 24 years of age, was $13,957 in 1979, lower than the average (mean) income of $14,730 where the head of household was 65 years of age or older. If the median average is used then the figures are reversed; $13,089 for the young heads of households, as compared to $11,316 for those 65 years and over.[a] When per capita income is looked at, younger families are at a comparative disadvantage because of their dependent children. Households headed by individuals 35 to 44 years, prime earning years, have average (mean) incomes about equal to those 55 to 64 years. Many of the latter have retired.

The December, 1981 issue of the Social Security Bulletin recognizes that, "The aged as a group are no longer disproportionately poor compared with the adult population as a whole..."(P.3) This conclusion is based on 1978 data about assets or wealth and income. Since 1978 those 65 years and older have continued to improve their relative position. Social Security benefits have been rising year-after-year faster than average wages and hourly earnings. Some federal civil service annuitants, after a few years of retirement, are receiving more in benefits than they would have earned if they had stayed in their job. The values of houses owned by the aged have continued to rise as have the values of their household, capital goods. Eighty percent of the aged own their own homes, with seventy percent of those having paid up mortgages. Medicare continues to increase annually its per capita benefits that provide hospital and physician services for those 65 and over. The capitalized value of Medicare is a substantial form of wealth for older persons. Because not all claimed hospital costs are reimbursed by Medicare, younger individuals are subsidizing the hospital costs of the aged through paying higher prices for their own medical care and insurance premiums. Medicare's costs are expected to grow about 16 percent in 1983 as compared to a 4 or 5 percent growth in total federal government outlays. Fourteen percent of those 65 years of age and older had, in 1978, $5000 or more income from assets. Over a third of those 65 years and older had a pension in addition to Social Security.

Even in 1976, among all persons 65 years and older, 52 percent had income in the form of interest on loans, as did 54 percent of those who were 62-65 years of age. Among older, married couples, 62 percent were in this category.

Most young, heads of households, twenty to thirty-five years, do not own their own homes, and if they do, they are likely to have a sizeable mortgage. Younger persons are borrowers, not lenders and they have not yet acquired vested pension rights.

None of the above data reflects double income tax exemption for those 65 years and over, or that Social Security benefits are tax free. These factors are reflected in per capita disposable income data. Disposable income after taxes is the relatively controllable income of individuals. Although there are poor individuals, especially among the older aged, among all those 65 years and over their average per capita disposable income in 1978 was $4,450 while that of the entire population was $3,412.[b]

In summary, federally financed benefits to the aged are absorbing an increasing share of the Budget. Many of the aged are not poor, while many young families are paying such high taxes that they do not perceive that they can afford to have children.

Social insurance implies two criteria: adequacy of benefits and individual equity. Social Security benefits were never meant to be the only income for persons upon retirement. Historically, the program has been commonly referred to as one leg of a three-legged stool. The second leg was savings, and the third leg, private pension plans. In recent years, a fourth leg could be added: earnings. Those individuals who continue to work after they reach 62 years are, on the average, financially better off than those at comparable ages who do not work.

During the past two years I have recommended that Social Security benefits should be indexed by the lower of the rise in the CPI or a suitable wage index. This would have saved billions of dollars from 1970 on, and would have stopped the transfer of real income from young to old. However, this has not been done and now that inflation is beginning to be controlled, the impact of this measure on the 1983 Budget would be less than in the past. However, I still believe that it is a good, long run policy and am happy that the Administration has proposed to reform federal civil service benefits along these lines.

The 1983 Budget indicates that many benefits in addition to Social Security are tied to the CPI. These include civil service and other federal retirement benefits. An annual one percent rise, once the three percent trigger for a retirement benefit increase is met, means about a $2 billion increase in the Budget for retirement plans alone. Therefore, at this time I recommend that Congress break the cost-of-living indexing of all benefits and increase them ad hoc, when the economy permits. Social Security benefits have been indexed only for the past seven years, and this might be considered a period of learning experience. The indexing of civil service benefits was first enacted in 1962. It has been estimated by the Congressional Research Service that in 1982, the gross cost increases due to all of the various indexed provisions will amount to $26 billion. This includes $18.8 billion for Social Security and $2 billion for civil service and railroad retirement combined.

If fewer people draw retirement benefits the toal costs of these plans can be contained. Therefore, I would make it less advantageous for persons to retire at ages 62 and 63. Only 18.5 percent of males are working at 65 years or older. This continues the long downward trend in male labor force participation that is partially offset by increasing numbers of women working. In early 1981, I developed the details of a gradual phase-in to the full benefit at age 67 which makes it increasingly disadvantageous to retire earlier. Over the next twenty years, the proportion of full benefits paid at age 62 would be reduced from 80 percent of the full benefit to 70 percent in 1985, 65 percent in 1988, and 60 percent by the year 2000. Proportions of the full benefit by the year 2000 would be: at age 63, 70 percent; at age 64, 80 percent; at age 65, 90 percent; at age 66, 95 percent; and at age 67, 100 percent.

The advantage of discouraging, but not eliminating the Social Security benefit for persons under 65 years of age is that it still leaves in the hands of individuals a choice, although at somewhat lower rates than is presently the case. Other economists would gradually eliminate receipt of any benefit paid to individuals under age 65 and permit a full benefit at age 68.

My plan would not affect anyone until 1985, and then only slightly those individuals who, in 1982, are younger than 60 years. A three-year planning period is short, but then the size of the financial imbalance in the OASI trust fund, 1982-86, will be large. This plan does not affect until 1995 any one who is planning to retire at age 65. These persons are under 50 years of age in 1982. Although one particular age cohort is more adversely affected than others, this has been true throughout the program's history. Among current beneficiaries, no one has paid--in an actuarial sense--for their benefits, while those in much younger age cohorts are paying, especially if they are not married, more than the actuarial equivalent, as do individual earners in two-worker families. The plan recognizes the longer life expectancy of three years at birth since Social Security was enacted in the 1930s. Seven percent of the Budget supports about $32 billion of retirement and disability benefits to civil service annuitants, $16.6 billion in military retirement benefits and nearly $6 billion in railroad retirement benefits. All these programs are indexed to the cost-of-living.

Civil service annuitants, it is claimed, have paid for their pensions, yet in 1980 general revenues paid 46.5 percent of the revenues to civil service retirement trust funds, in addition to 7 percent of payroll. If ERISA accounting requirements were applied to civil service, the cost would be 80 percent of payroll. The unfunded, accrued liabilities for civil service, foreign service and military benefits is about $1 trillion. The high level of civil service benefits to pay has encouraged 75 percent of federal workers between 54-60 years to retire. Integration of civil service benefits with Social Security benefits would yield several billion dollars the first year from OASDI taxes paid on the primary earnings of federal workers. In 1979, 70 percent of all male civil service workers already had entitlement to both Social Security and civil service benefits, while 86 percent of the men employees under 55 years of age had potential dual coverage. Because most federal civil service annuitants receive a heavily weighted Social Security benefit based on low, secondary earnings, I estimate long run savings of 0.5 percent of payroll. I recommend the integration of civil service retirement and Social Security plans. The informed public views this as an equity issue. At the same time I would make the government worker's civil service retirement contribution a deductible, as are similar contributions to private pension plans deductible before income tax payments.

The Administration has recommended that federal workers, most of whom receive Medicare benefits at age 65, be required to pay the 1.3 percent tax on their earnings up to $32,400 annually, that other workers pay to support Medicare. The philosophy behind Medicare is that people pay prior to retirement when they are earning money, so as to pay in part for their medical care when they are retired and not earning money. I support this recommendation, but would, as I have indicated, go further.

HEALTH

Costs of medical care nationwide absorb 9.4 percent of the Gross National Product. The Administration's Budget for 1983 estimates federal government expenditures of $77.8 billion and CBO estimates of $78.6 billion. The federal government's primary bill is from Medicare: Part A, reimbursement of hospitals and Part B, payment of physician's bills. The Reagan Budget Authority for 1983 is $6.59 billion higher than for 1982, and the estimate for Medicare outlays $5.8 billion higher. These amounts are, however, lower than earlier government estimates of Medicare's total bill in 1983.

Third parties, private insurers and government, pay 94 percent of all hospital bills. Medicare has a deductible equal to the cost of the first hospital day ($260 currently) and co-insurance after only the sixtieth hospital day. The Administration notes the wide differential in per capita hospital days of Medicare patients--48 percent more in the Northeast than in the West--and recommends striking the waiver of provider liability for the costs of "unnecessary or uncovered care" and setting targets to reduce unnecessary use of hospital and medical care. Co-insurance beginning at the sixtieth day might be timed much earlier to reduce hospital stays that are longer than necessary. The average length of stay for Medicare patients is eleven days.

The largest revenue yielder of the Administration's numerous proposals is to reduce the rate of increase of Medicare hospital reimbursement by 2 percent, yielding $653 million in 1983.

As already mentioned, the Administration would also require federal workers to pay the health insurance portion of the F.I.C.A. Tax that supports Social Security, yielding $619 million. I agree with these two recommendations, but urge that incentives be constructed so that hospitals keep accounts as do other private businesses.

The federal government is expected to pay out nearly $19 billion in Medicaid matching grants to the states in 1983. Medicaid gives the poor a legal right to medical care, but also Medicaid defines in part who is poor, and mandates the types of medical care that a state must provide: patient and out-patient hospital, laboratory and x-rays, physician care and other services. Wealthier states such as California, offer more optional sources and have "optional beneficiaries," those above the poverty line. The Administration would reduce the Federal match for such optional expenditures by 3 percent, thus saving several million dollars in 1983. This, and a small co-payment charge of $1 for an out-patient visit and $2 for each in-patient day, saving $329 million, seems reasonable. The $1 co-payment office visit charge might even restrain demand for medical care for minor problems. All the other specific Medicaid reform proposals would each save less than $300 million, although they do add up to save several billion dollars.

The federal government's costs of providing health care under Medicare and Medicaid have been growing rapidly, not because they are indexed to the CPI, but because of rising utilization rates and prices of medical care, and the increasingly complex and costly technology that saves lives.

Medicare, in essence, establishes for persons 65 years and over a right to some portion of catastrophic medical expenses. The program was fashioned along the lines of private health insurance and uses deductibles and cost-corridors to contain costs.

Medicaid, in essence, establishes for the poor a right to a broad spectrum of care. The poor have had, tradionally, access to emergency medical care, based on humanitarian and moral grounds. Emergency medical care can be definedstrictly or broadly. Even if broadly defined, only a small part of medical care is emergency care. Medicaid, therefore, greatly expanded for the poor access to medical care.

To contain costs of medical care successfully is a complex, long-run task that cannot be addressed in brief testimony about a one-year budget. To indicate my views I briefly quote from my new book, being released March 21, 1982 (University of North Carolina Press) as follows:

> From a cost-benefit point of view, more dollars spent on research and prevention should yield higher net benefits than additional dollars spent to extend the lives of elderly people for whom there may be no cure and whose quality of life may be diminished...A new development has been alliances between industry and universities to develop further basic and applied research.
>
> In either a relatively private market system or a government-run, national system of health care, decision making by the physician is divorced from efficient allocative decision making. The closer the health care markets come to competitive markets with their attributes of full information and free entry, the closer will be the efficient allocation of scarce resources. (The Economics and Politics of Health, P. 303.)

More informed consumers, industry purchasing leverage, advertising and anti-trust action,as in other industries, can result in greater cost-containment.

I have stressed in my testimony restraint on outlays because I do not believe that taxes should be increased. Government continues to grow if the revenues to spend are available.

Testimony Footnotes

a) Money Income & Poverty Status of Families & Persons in the United States: 1979 (P-60, No. 25, Current Population Reports of the Bureau of Census. P.16).

b) Michael Hurd and John Shoven, "Real Income and Wealth of the Elderly". Working Paper, Hoover Institution, Jan. 1982, Mimeo, P. 4.

c) Indexation of Federal Programs, May 1981, P. 15. Prepared by the Congressional Research Service for the Committee on the Budget, United States Senate, Govt. Printing Office, Washington, D.C., May, 1981.

Appendix A

Appendix A Ricardo-Campbell's Proposed Percentages for Social Security Retirement (by age)

Social Security	Current Full	Intermediate Goals			Long Range Goals	
Entitlement Age	Benefit	1985	1986	1988	1995	2000
62	80.0%	70%	68%	65%	65%	60%
63	86.7	80	78	75	75	70
64	93.3	90	90	90	90	80
65	100.0	100	100	100	95	90
66	100.0	100	100	100	100	95
67	100.0	100	100	100	100	100

Senator Boschwitz. We will resume the hearing.

We will conclude the hearing now with Mr. Bosworth. Mr. Bosworth, I appreciate your being patient with us. If you would proceed, I would appreciate it.

STATEMENT OF BARRY BOSWORTH, SENIOR FELLOW, BROOKINGS INSTITUTION

Mr. Bosworth. Sir, I have a statement which was prepared and, I think, can just be inserted in the record. Let me just make a couple of comments. So much has been said today that I do not think it is necessary to repeat it all.

Senator Boschwitz. Without objection, your statement will be inserted.

PREPARED STATEMENT OF BARRY BOSWORTH,* SENIOR FELLOW, BROOKINGS INSTITUTION

I am pleased to appear before this committee to respond to questions you may have about economic policy in 1982 and beyond. Given several months of intensive public discussion, there is little that I can say that is new to this committee. Let me briefly summarize the major issues that I believe to be relevant to this year's budget planning.

1. We are apparently reaching the bottom of a recession in which unemployment will level out at about 9 percent of the labor force. This recession and that of 1980 can be viewed as the expected result of a monetary policy designed to reduce inflation.

Monetary restraint has slowed inflation by reducing sales, production, and employment. In addition, higher domestic interest rates, by attracting foreign capital, led to a rise in the value of the dollar and a decline in the price of imported goods. The high costs of borrowing also forced many holders of primary commodities to unload their inventory stocks, further depressing prices. Favorable developments in world energy and grain markets have also been important factors. While the overall inflation rate has declined by 3 percentage points during 1981, much of the price deceleration has been the result of these special factors and future gains in reducing inflation are likely to come more slowly.

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* The views expressed are my own and are probably not those of the officers trustees, or other staff members of the Brookings Institution.

Meanwhile, unemployment has increased from 6 percent in 1979 to close to 9 percent in early 1982; total output has not grown; and capital formation has fallen below the level of 1979. As in past recessions the reduction in inflation has been achieved at substantial costs.

2. The Federal Reserve's money target for 1982--2-1/2 to 5-1/2 percent growth for the M1 definition of the money stock--implies that monetary policy will continue to limit future economic growth severely. By definition nominal GNP growth is equal to the sum of the rates of growth of money and its velocity of circulation (the ratio of GNP to the money stock). With velocity growing at the 3-1/2 percent annual average of the 1970s, nominal GNP growth could be no more than 6-9 percent. If inflation declines to 7 percent as forecast by the administration, the upper range of the monetary targets would allow for real GNP growth of only 2 percent. In practice, of course, the velocity of money can fluctuate sharply over a period as short as a year; and higher velocity growth can be achieved by progressively higher interest rates, as users are offered incentives to economize on money balances. The continuation of high interest rates, however, is likely to choke off any economic expansion by limiting the growth in

business investment, housing, and other credit-sensitive sectors. The Federal Reserve's policy can be most simply understood as a refusal to finance any economic expansion until inflation recedes to substantially lower levels.

3. The administration has announced its support for the policy of sharply limiting the growth of money and credit. It is, however, unwilling to recognize that the policy of monetary restraint is not compatible with its own desire for a rapid economic expansion. Believing instead that the announcement of a tough monetary policy will make inflation go away without major losses in real output or jobs, the administration has moved forward with a budget policy that presumes the economy will be growing rapidly through the mid-1980s, combining large tax rate reductions with major increases in defense spending. Furthermore, doubts that the administration can achieve offsetting expediture reductions in other budget categories has created expectations that fiscal policy will be even more stimulative than intended in future years.

4. It is this potential for conflict between an extremely restrictive monetary policy and a highly expansionary fiscal policy, that has dominated discussions of the economic outlook. There are several implications for the economy if this dispute can not be resolved. First, while the tight monetary policy implies slow growth in overall demand, the effort to finance budget deficits in the range of $100-150 billion dollars implies high interest rates and a

significant reduction of funds for private capital formation. The potential for even larger budget deficts(because some of the administration's proposals are unlikely to be approved), has some economists perdicting even more extreme situations of crisis in financial markets. in that situation the level of total output as well as its composition would be seriously affected.

5. The policy dispute has two different aspects. How restrictive should overall policy be? And what should be the mix between fiscal and monetary policy? Clearly the monetary authorities believe that their perscription ofslow growth to reduce inflation is the correct one, and they believe that fiscal policy should be brought into line with that objective by reducing the prospect for larger future budget deficits. Others might deplore the continuation of unemployment in the range of 8-9 percent of the workforce, and believe that both monetary and fiscal policy should aim at higher targets for economic growth in future years.

On the other hand, whatever overall growth of demand is permitted, the mix of fiscal and monetary policy will have important implications for capital formation and economic growth in the future. Increased reliance on fiscal restraint would promote a higher rate of future growth by reducing consumption and allowing for a higher share of output to be allocated to capital formation. Political conflict over whether the fiscal restraint should be achieved by reducing expenditures or increasing taxes does obstruct such a shift in policy.

But, in addition, a more restrictive fiscal policy must be coordinated with the Federal Reserve. Fiscal restraint will, without compensating monetary expansion,reduce interest rates, but only at the cost of further reductions in production and employment . Many of the recommendations for tighter fiscal policy actually reflect such a desire for more overall restraint to speed the reduction of inflation. A desire to shift the mix of policy, without reducing the level of total output, however, requires offsetting changes in monetary policy. In economic terms the two issues of the degree of total restraint and its mix are quite separate, but both are involved in the current argument over economic policy.

6. What does this all have to do with Budget Policy? That depends on the magnitude of budgets deficits that are being discussed. If we begin with the budget outlook under the assumptions of the current services budget of the Congressional Budget Office; the budget deficit could rise to in excess of $200 billion by 1985. Such a fiscal policy is clearly too expansionary and lies behind some forecasts of a financial crisis. Restrictive actions are warranted without the need to consider compensatory monetary policy changes.

For budget deficits near $100 billion and below, however, the appropriate mix of fiscal and monetary policy becomes a critical issue, because the additional fiscal restraint could translate into significantly lower than intended levels of total output. Thus, actions toreduce the deficit below the levels proposed by the administration will require the cooperation of the Federal Reserve if a worsening of the current recession is to be avoided.

7. How did the deficit get so large?

In part it is the continuing reflection of the pattern of the 1970's where revenues were never sufficient to finance expenditures--an average deficit of about 1-1/2 - 2 percent of GNP or about $75 billion per year. In addition, since 1979 the monetary restraint has sharply raised expenditures on interest payments, unemployment insurance, and other social expenditures, and reduced revenues--another $50-70 billion annually over the next several years.

Some of the sharp rise of expenditures as a share of GNP in recent years was camouflaged in terms of the deficit by an increase in taxes as a share of GNP. But, the 1981 tax program reversed that trend and reduced taxes as a share of GNP below the normal levels of the 1970's. This failure to match tax and expenditure actions threatens to add an additional $50-100 to the deficit in future years.

One means of visualizing the magnitude of the deficit is that if defense, social security, medicare (all items which the administration proposes to exclude from cuts), and interest payments are set aside, the elimination of all other government programs, would still leave us with a deficit.

A summary of these shifts in the budget is shown in table 1. The sharp rise in expenditures, as a share of GNP, is clearly evident between 1979 and 1981; yet it had little impact on the deficit because

Table 1. The Budget Outlook in Early 1982

Percentage Shares of GNP

	Percentage of GNP		
Category	1979	1981	1985
Expenditures	20.9	23.0	24.1
Defense	5.0	5.6	7.1
Payments to Individuals	9.7	11.1	10.9
Net Interest	1.8	2.4	3.4
Other	4.4	3.9	2.7
Revenues	19.7	21.0	18.3
Deficit	1.2	2.0	5.8

Source: CBO projections plus administration defense program.

of the rise in the effective tax rate. In future years, defense and interest costs continue to rise,while revenues decline. Thus, the future budget deficit is the result of a sharp shift in budget priorities toward higer defense spending and tax reductions, and it can not be traced to runaway increases in entitlement programs.

8. One major area of potential reduction is that of the indexed payments to individuals, which expanded four-fold between 1970 and 1980 and totaled about $275 billion in 1980. Social Security and Medicare accounted for $155 billion; welfare and medicaid were $45 billion; and government retirement is the biggest element of the remainder. Thus, significant action in the entitlement area really means dealing with the social security program. The rapid growth of social security benefits during the last decade reflects two separate factors. First, in the early 1970s, when the Congress adjusted benefits by direct action, benefits were increased in real terms by about 15-20 percent. Second, after the shift to automatic indexation, benefits increased in line with the CPI; but special features in that index boosted benefits by about 10 percent compared to alternative measures of inflation.

The major problem of the price index — the treatment of homeownership— will be reduced when the new CPI is introduced in 1983. It will still not address some potential problems caused by major price changes in some other areas, such as higher imported oil prices.

Some social security recipients have benefited from the large increases in the CPI that were caused by the move to higher interest rates, but the extent to which that is true depends on the number of years that they have been receiving benefits. A reduction in the general benefit payment to offset the alleged overpayment would not be fair to recent retirees. I also understand that it is difficult for the Social Security Administration to distinquish among existing retirees in attempting to adjust future payments in any kind of offsetting fashion. Thus, I do not believe that the alleged past over-payment provides the basis for a significant general reduction of benefits in the future.

While rising benefit payments to individuals were the source of the rise in government outlays as a share of GNP in the 1970s, that does not appear to be the situation in the 1980s. There is little sentiment to raise the level of real benefits, the growth in the number of beneficiaries is expected to slow, and the new CPI will be less sensitive to short-run fluctuations in interest rates. Instead, the political debate is about reducing benefits because of a shift of national priorities to more defense spending and lower taxes. Proposals to limit future cost-of-living increases to the rise in the CPI minus 2 percent,for example, are simply proposals to reduce benefits by 2 percent.

Mr. **Bosworth**. I would like to just make a couple of comments with respect to the role of entitlements and potential cutbacks in magnitudes of the budget deficit.

I think, one, that the whole issue of the entitlements programs comes up for consideration of some changes because the magnitude of the budget deficit in future years is so large. In attempting to try to reduce the budget deficit of the magnitude that we now face for the years of the eighties, I think the approach the Congress is going to have to follow is it is going to have to consider almost everything.

BUDGET DEFICIT CONSISTS OF THREE PARTS

I would like to just say a word, though, about why it is so large. I think there are really three parts to that budget deficit that threatens to run in excess of $200 billion out in the years around 1985.

First of all, about $75 billion of it is just a reflection of the fact that there has always been a budget deficit. We have not had a balanced budget throughout the 1970's. Taking the average size of that budget deficit as a share of GNP of somewhere between 1.5 and 2 percent, it would add about $75 billion dollars' worth of budget deficits annually in future years.

Second, and the one I think has gotten overlooked a great deal, there has been an enormous increase in the magnitude of the budget deficits since 1979 as a predictable result of monetary policy restraints designed to try to slow down the economy's growth and reduce inflation. That, too, is adding about $50 to $75 billion dollars worth of extra deficits between now and 1985 annually simply because the monetary restraint has meant much higher interest rates, which the Federal Government, along with other borrowers, has had to pay. The recessions, two since 1979, a recession in 1980 and a recession in 1981, have both drastically increased payments for unemployment insurance and other programs and reduced revenues.

The third component of it, though, the part that carries it far beyond any range that the United States has ever experienced in peacetime of past deficits, is the actions that the Congress took last year to cut taxes over a 3-year period without any compensating changes and reduction of the magnitude of the expenditure side.

PAYMENTS TO INDIVIDUALS HAVE INCREASED SUBSTANTIALLY

The table that I included with my testimony[1] is an attempt to try to illustrate the magnitudes of that. I think three interesting points I would like to make about the payments to individuals, which is the major part of the entitlements program, are these.

First of all, looked at as a share of GNP, which I think is a more reasonable way to look at it so that we do not get just big numbers because of inflation over the past decade, looked at as a share of GNP, payments to individuals have gone up substantially in the 1970's, from about 6.5 percent up to today in the budget, they are running around 11 percent of GNP. That magnitude of increase, though, can be identified and what caused it.

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[1] See p. 219.

First of all, there is about a 15-percent increase in social security benefits in the early 1970's during the period when these payments were discretionary adjustments. Then, starting in 1975, social security was indexed. A mistake was made, in retrospect, of the index that was chosen for purposes of indexation. We used the Consumer Price Index. The tremendous increase in home prices and mortgage interest costs gave an unrealistically high rate of inflation.

Senator BOSCHWITZ. Where are you in your testimony?

Mr. BOSWORTH. Table 1, which is between——

Senator BOSCHWITZ. You are not reading?

Mr. BOSWORTH. No. I am just going to summary those points, which is page 6 and page 7 in my prepared testimony.

Senator BOSCHWITZ. Fine.

Mr. BOSWORTH. That increase in the CPI in excess of other measures of inflation added another approximately 10 percent to the increase in social security benefits over the last half of the 1970's.

The third major factor that accounted for this enormous increase in payments to individuals, seems to me, was the cost of medicare and the decision to move in the mid-1960's to financing a medical care program for the elderly and for the poor. The start-up cost of that program and its extension to more beneficiaries proved to be very expensive.

PAYMENTS TO INDIVIDUALS PROJECTED TO DECLINE

If we look ahead from now into the future, the interesting point is that payments to individuals are no longer expected to rise rapidly as a share of GNP. In fact, in this whole issue of the deficit, payments to individuals are actually projected to decline very slightly relative to the other components of the budget. Thus, the story of runaway increases in payments to individuals seems to me was a very important story in the seventies. It is unlikely to be the story of the eighties. In fact, today's discussion of what to do about payments to individuals is not really an issue of controlling the rate of growth in them in future years because I do not think that they will rise anymore as a share of GNP. Instead, the real issue is, that we are debating, is whether or not we want to cut those benefits.

It should be approached, it seems to me, from the perspective of reducing benefit payments to individuals because some people would argue that national priorities have shifted toward a higher level of defense spending and large tax reductions to individuals. But it is that issue, of whether or not it is reasonable to cut benefits to individuals, that I think underlies the current discussion of the deficit, at least as it relates to this component of the entitlement program.

Why do I not stop with that, since the full statement can be inserted in the record.

Senator BOSCHWITZ. You give us a little different viewpoint on the subject. I am not quite sure what you gave us by way of suggestion or solution. We should not look at the entitlement portion of the budget; is that correct?

NEW CPI PROPOSED

Mr. **Bosworth**. I think the major problem of runaway increases in the entitlements part of the budget, the reason that it occurred in the recent years has been the result of the Consumer Price Index being used as the index to extrapolate it. That has now been changed. The action has been taken so that, starting in 1983, a new consumer price index will be produced by the Bureau of Labor Statistics that will correct for the major difficulties that this form of indexing faced in the past.

When I look back at the historical record, should you index or shouldn't you index, I do not see any difference. When Congress had the power to act discretionarily, it increased benefits very sharply. When it did it automatically, they also increased very sharply. I do not see that there would be much reason to expect that the elimination of indexation and doing it on a discretionary basis will make a particular difference.

Senator **Boschwitz**. I am told we are going to begin using that for social security in 1985.

Mr. **Bosworth**. It depends on when the Congress decides they want to do it. The index will be available in the Bureau of Labor Statistics starting at the end of 1983, I believe is when they scheduled it for reform.

Senator **Boschwitz**. So, you feel that there should not be any change in the way that the entitlement programs are treated on a CPI basis?

Mr. **Bosworth**. As far as the indexing itself and the difficulties that have been discussed in past years, I think the proposal of the Bureau of Labor Statistics is the correct proposal for how to change the index. I favor the new index that they are introducing and believe it will eliminate most of the problems associated with indexing in the past.

The question of whether or not the Congress should cut benefits, it seems to me, is not an economic issue; it is a political issue. I do not particularly have any views on whether or not the retireds benefits are too high or too low.

On the technical issue of the indexation, I think the new procedure will repair most of the damage that was present before.

Senator **Boschwitz**. I thank you very much, Mr. Bosworth. I will read your testimony with some care.

I appreciate your patience this afternoon. I appreciate the patience of all the witnesses. Thank you for coming. We will be in touch with all of you as we develop our thoughts still further.

The hearing is adjourned.

[Whereupon, at 5:20 p.m., the meeting was adjourned.]

TAX EXPENDITURES

WEDNESDAY, MARCH 17, 1982

U.S. Senate,
Committee on the Budget,
Washington, D.C.

The committee met at 10:20 a.m., in room 6202, Dirksen Senate Office Building, Hon. Pete V. Domenici (chairman) presiding.

Present: Senators Domenici, Boschwitz, Kasten, Gorton, Chiles, and Metzenbaum.

Staff present: Stephen Bell, staff director; Peter Davis, senior economist for tax analysis; Lizabeth Tankersley, minority staff director; and Kemble Stokes, chief economist.

OPENING STATEMENT OF CHAIRMAN DOMENICI

Chairman **Domenici**. Our first witness will be John E. Chapoton, assistant secretary for Tax Policy, U. S. Department of the Treasury. Then we have a panel to follow.

Let me clarify something about the committee print on tax expenditures.

It will be available later today. It describes each of the 104 tax expenditures: how much revenue they cost; their economic impact; and why they were added to the tax law. There is also a detailed bibliography for further study. This book updates the yellow book tax study issued in September 1978. At last November's tax expenditure hearings, Senator Kassebaum and Senator Gorton asked me to revise this work to include the 20 tax expenditures that have been added to the Tax Code since 1978.

Over the last 3 months, our staff and those of the Joint Committee on Taxation, the Congressional Budget Office, and Congressional Research Service have labored to complete this work for this hearing. I thank them for their effort and commend the study to everyone.

TAX LAWS NEITHER SIMPLE OR EFFICIENT

Mr. Chapoton, I welcome you in your first appearance before the Senate Budget Committee. This is not exactly the Finance Committee where I am sure you spend more of your time, but we on the Budget Committee do have an abiding interest in a simple and efficient Federal tax system. Few would argue that our current tax laws are either simple or efficient. We have lived too long with a system which excludes nearly half of all income from taxation and which uses a combination of high marginal tax rates and inflation to increase taxation without any vote of Congress. As a consequence, we now face an economy in deep recession mired in high marginal tax rates. We can no longer afford inefficient special tax provisions any more than we can survive the incentive robbing effect of the highest marginal tax rates in history.

The Economic Recovery Tax Act of 1981 did much to restore full capital allowances to revive American business. It also provided the largest marginal tax rate reductions ever, even though the truth of the matter in real terms is that we have just held flat the level of taxation. Unfortunately, this historic act did not stop there. Tax expenditures for just fiscal years 1982 through 1984 were increased $82 billion. That represents 63 percent of the $130 billion of reconciliation savings for which we fought so hard last year. Even as the growth in outlays has been pared to 8 percent, tax expenditures are projected to grow at 13 percent in fiscal year 1983 and beyond. Clearly the budget battle to reduce spending and deficits cannot succeed unless control of tax expenditures is made part of the solution.

TAX EXPENDITURE BUDGET

The administration's tax expenditure budget in special analysis G is the primary point of departure for any discussion of tax expenditures. I understand that this year's budget made several changes from past practice. These included the deletion of eight tax expenditure items, the elimination of the breakdown between corporations and individuals, and the addition of outlay equivalent estimates. These changes have not been adopted by the Joint Committee on Taxation or the Congressional Budget Office in their tax expenditure budgets. Up until now, there have been very few differences among these budgets.

The purpose of today's hearing is to explore the issue of what should be included in the tax expenditure budget, how useful is the tax expenditure concept in comparing Federal tax policy with Federal spending decisions, and to to see if control of tax expenditures under the Budget Act would be desirable. These issues are often discussed in the abstract, but this year it is possible to discuss them in the context of the very immediate concerns over safe harbor leasing and the proposed alternative corporate minimum tax.

SAFE HARBOR LEASING

I have been distressed to find that safe harbor leasing has allowed one company with sizable profits to reap additional tax benefits even though they have not paid any Federal income tax in the last 3 years. Just yesterday there was a front page story of another company which revealed in its annual report that it anticipates receiving a $100-million tax refund this year from leasing. That would be the largest tax refund in U.S. history.

Rather than do away with safe harbor leasing entirely, the administration has proposed to limit leasing benefits by including them in alternative corporate minimum tax. I believe that all profitable corporations should pay some tax. Only 47 percent of U.S. corporations, not including subchapter S corporations, pay any Federal income tax. Corporate tax collections have declined from 30 percent of total taxes during the fifties to just under 10 percent in the eighties. I am puzzled, however, over the apparent inconsistency of the administration's support for leasing and for the minimum tax to reduce leasing benefits. Mr. Chapoton, I have faith that there are some principles of taxation at work here, but I need your help to find them.

I understand Senator Metzenbaum would like to make a brief opening statement. We will depart from our usual procedure and permit that.

I would appreciate it, Senator, if you would keep it as brief as you can. You may proceed.

OPENING STATEMENT OF SENATOR METZENBAUM

Senator Metzenbaum. Thank you, Mr. Chairman.

Mr. Chairman, I think there is no subject that is more deserving of the attention of this committee, as well as the entire Congress, as the subject of tax expenditures which, in some instances, and not all, that is for sure, but more appropriately could be called tax loopholes.

50 PERCENT OF CORPORATIONS WILL NOT PAY INCOME TAX BY 1985

When 16 U.S. Senators, all of whom are new Members of this Senate and all of them who are Members of the majority party in the Senate, see fit to write to the President of the United States about the fact that by 1985, 50 percent of the corporations in this country will not be paying any corporate income tax, I think the shocking aspect of inequity and unfairness comes home to rest pretty well. When we see in the newspapers about General Electric picking up $1,700 million by selling its tax losses while it still made almost $2.7 billion, and Occidental picking up $20 million by selling, although it made $750 million. When we see the fact that timber companies are treated different than any other group of people, farmers who grow their products, whether it is soybeans or wheat or corn, who pay regular taxes, but timber companies pay only 50 percent of their taxes because they are treated as capital gains, that costs us $600 million a year. When we see the fact that many companies, including many of the pharmaceutical companies, take their operations to the islands and they wind up paying zero taxes, and this costs the Federal Treasury something like $1,200 million a year; when we see the fact that banks are giving special privileges to no other group that society has given, that is, to have an artificial figure with respect to a writeoff of their bad debts, that does not really relate to reality.

When we see the fact that oil companies, day in, year in, reap; they are given special advantages that no other segment of industry is given, and now we find that oil companies are naturally going to be able to shelter their profits from other parts of the—of their company by reason of the purchases that they make of new equipment. And frankly it just does not make sense to us to permit any company, oil company or any company, to be able to recover from the Federal Government more than 100 percent of the cost of the products that they are buying, and that is possible under the law at the present time. It is particularly possible with respect to oil companies. We could and should be able to pick up something in the area of $20 billion a year by just closing some of the egregious tax loopholes that presently exist. And indeed, today, when we are making every effort to balance this budget, for us not to zero in and say to the Finance Committee you can find $20 billion, and it is your responsibility to do it.

I am aware of the fact that we are not a tax writing committee, but I am also aware of the fact that we have some authority as it pertains to directing other committees, as pertains to their responsibility. There can be and should be that kind of dollars brought home.

TREASURY SHOULD COME FORTH WHERE INEQUITIES OCCUR

Now, I have looked at the testimony of Mr. Chapoton on behalf of the Treasury Department, and I noted, he refers to two or three items of tax expenditures and says that these are areas that apparently are being given some attention by the administration. We have no difficulty with the Treasury Department when we have some proposal on the floor of the Senate that has to do with an impact upon revenue. I think the Treasury, if the Treasury Department can come before the U.S. Congress and say yes or no with respect to a pending amendment when tax legislation is on the floor of the Senate or the House, then I do not understand why the Treasury Department does not have the same responsibility to come forth and make its recommendations in connection with a host of areas where they know that tax inequities occur. And I would say that that, in my opinion, is part of the Treasury Department's responsibility, separate and apart from the policy considerations of the Secretary of the Treasury.

I think this issue cries out. When you go out and speak to people in my State about tax loopholes, when you talk about the inequities, when you talk about unfairness, when you talk about some not paying anything and so many others having to pay so much, there is really a hue and a cry and a revolution, and then we find that Mr. Walker is going to appear before us today and he is going to say that the American Council for Capital Formation strongly opposes attempting to cutback on deficits through subjecting the tax expenditures to the budget process. I think that Mr. Walker perhaps ought to be willing to explain to us what kind of pressure he was able to bring on the Treasury Department as reported in the Washington Post, when it says that Walker and the chief executive officers of his corporate clientele had the responsibility of softening up Treasury officials reluctant to take a position and might appear to be a Federal subsidy. That was in connection with the whole matter of the safe harbor leasing provisions. And for Mr. Walker to appear before this committee, he being the architect of the Safe Harbor Commission, it is probably costing the Treasury $6 billion at the present time. And to say that the chief beneficiaries of tax expenditures are not wealthy insurance individuals and corporations but are low- and middle-income individuals who will receive 70 percent of the total, that is indeed a fact, and I do not question that as a fact except that he recognizes how he is always stating a part of the story because he is talking about mortgage interest being deductible and such items as that.

PICK UP $20 BILLION TAX EXPENDITURES PER ANNUM

Mr. Chairman, I believe as I looked over the report, the statement of Mr. Walker and Mr. Chapoton, that we are not zeroing in on the issue. And I would hope, under your leadership, and I know that you have addressed yourself in part to this subject as has the Chairman of the Finance Committee, I would hope that there would be some strong and dynamic activities and strong and effective push to see to it that we direct the Finance Committee to pick up at least $20 billion in the area of tax expenditures per annum, and that that amount would increase. I think it is possible. I think it can be done. I think it should be done, and I do not think that it would have any effect whatsoever on the whole concept of supply side economics, and making it possible for industry to be able to use their funds to further production efforts in this country.

I thank you, Mr. Chairman.

Chairman DOMENICI. Thank you very much, Senator.

Secretary Chapoton, we have your prepared remarks. You may proceed either to deliver them or to give us your analysis of them. It will be made a part of the record in any event.[1]

STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. CHAPOTON. Thank you, Mr. Chairman. I will go through the remarks but I will try to summarize to the extent possible to save time.

THE LABEL "TAX EXPENDITURES" IS MISLEADING

I am pleased to be here today to appear before this committee on the subject of tax expenditures. As I think everyone would agree, there are many provisions of the Internal Revenue Code specifically designed as incentives to encourage selected economic activities or to provide relief from hardship. These special tax provisions are commonly referred to as tax expenditures, and I will therefore use this term in my testimony today. However, it should be noted that the label tax expenditure is misleading. Special tax provisions are not equivalent to direct Government expenditures on goods and services. Direct expenditures involve the purchase of labor, capital, and materials that are used directly by the Government to achieve public goals, such as national defense. In contrast, most special tax provisions provide a subsidy to an activity carried out in the private sector. For this reason, the label "tax subsidies" may better describe these special tax provisions than does the more conventional term "tax expenditures." But even the label "tax subsidies" is misleading, for many special tax provisions simply reduce disincentives in our tax code. This is particularly true in the case of special tax provisions which have the effect of reducing the double taxation of corporate income.

The administration is opposed to attempts to legislate blanket, across-the-board limitations on tax expenditures. Such limitations do not account for the different, sometimes highly desirable, effect of different tax expenditures. Instead, this administration is committed to a reevaluation of all Government activity in the economy, whether that activity is undertaken through direct outlay and subsidy programs, loan and loan guarantee programs, regulations, or through tax expenditures. Resources can be allocated to achieve public goals by each of these methods, and they must therefore be evaluated. But that evaluation must deal with each program, regulation, or tax provision individually on its own merits.

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[1] See p. 236.

For Government management purposes, it is essential that the resource cost of Government programs be comparably measured, regardless of the particular method by which the allocation of resources is accomplished. The concept of tax expenditures was developed to provide such comparability between programs effected through special tax provisions and programs effected through other methods. Properly defined, measured, and applied, therefore, the tax expenditure concept can serve as a very useful management tool. Like many other concepts, however, it is subject to misuse as well as misunderstanding, and therefore has received some well-founded criticism.

DEFINING TAX EXPENDITURES

Section 3 of the Budget Act defines tax expenditures as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." This definition requires a distinction to be drawn between the special provisions of the tax structure, which are designed to achieve public goals, and the normal provisions, which are necessary to make the tax system operational. Obviously, there are different ways to draw this distinction, a point to which I will return in a minute. What follows, then, is the administration's view of how this distinction should be drawn.

The normal provisions of the income tax include the definition of income subject to tax and allowable deductions, including some provision for the recovery of the cost of depreciable assets; taxable units and their threshold levels of taxability; the relationship between the taxation of corporations and their shareholders; the schedule of tax rates; the basic tax accounting rules, including the accounting period for taxation and whether income is taxed as it is realized or as it accrues; the treatment of international transactions; and the system of tax administration. Unlike the special tax expenditure provisions, these normal provisions are essential to the income tax.

In our view, for a provision to be special, two conditions must be met:

The provision must apply to a narrow class of transactions or taxpayers; and

There must be a general provision to which the special provision is a clear exception.

An example of a tax expenditure is the statutory exclusion of certain fringe benefits, such as employer-paid medical insurance premiums, from the taxable income of employees. The inclusion of wages in the tax base is a normal rule of the tax code, and the exclusions of these fringe benefits are special provisions and, therefore, constitute the tax expenditures. Other examples of tax expenditures include special provisions that promote home ownership, exports, and employment of the handicapped.

FEATURES TO BE NOTED

Several features of the tax expenditure concept should be noted.

First, while the distinction between the normal and special provisions of the income tax may be clear in the abstract, in practice there is always difficulty in applying the distinction in order to delineate tax expenditures.

Second, the definition of tax expenditures should not be taken to suggest that the normal tax provisions involve no tax incentives or disincentives. In fact, some of the normal provisions of the income tax have effects very similar to special provisions.

A good example of this similarity is provided by the Accelerated Cost Recovery System (ACRS) rules and the investment tax credit. Any income tax requires a set of rules for determining how the cost of depreciable assets is recovered. The ACRS provisions now constitute the general income tax rules for that purpose, and therefore they are not listed as a tax expenditure in Special Analysis. In contrast, the investment credit is considered a tax expenditure because, unlike ACRS, it does not deal with one of the basic structural elements of an income tax.

Third, there are other possible definitions of tax expenditures. It has often been suggested that tax expenditures be defined relative to the standard of an "ideal" income tax. However, there is no consensus among tax experts on the structure of an "ideal" tax relative to which special (tax expenditure) provisions could be delineated, and few would seriously regard an "ideal" tax as a practical tax structure. For example, under an "ideal" income tax, the rental value of owner-occupied housing would have to be added back (imputed) to homeowners, money income to arrive at the "ideal" income tax base. In addition, using an "ideal" income tax as a standard, the double taxation of dividends at the corporate and individual levels would constitute a negative tax expenditure.

The more common approach to tax expenditures has simply been to list possible tax reform items. This approach has led to much confusion about the concept and measurement of tax expenditures.

Fourth, the fact that a provision is a tax expenditure under this definition says nothing about the desirability or the effectiveness of the provision. This is also true, it should be noted, for direct outlay programs. The definition—and measurement—of tax expenditures is not a substitute for the analysis and evaluation of programs implemented through the tax system any more than a listing of direct outlays by program is a substitute for their evaluation. Further, the designation of a provision in the income tax code as normal does not imply that the provision is desirable.

NOT ALL TAX EXPENDITURES DESIRABLE

Clearly, there are many tax expenditures that serve desirable purposes in an efficient manner. The investment credit provides investment incentives for economic growth. The special tax treatment afforded pension savings, including IRA's and Keogh's, provide important incentives to save.

It is also clear that there are some undesirable tax expenditures and the administration has proposed to repeal or modify them. Specifically, under our tax proposals the business energy tax credits would be repealed, corporations would be required to capitalize and amortize construction period interest and taxes on commercial structures, and certain restrictions would be placed on issues of tax-exempt bonds for private activities.

In addition to repealing or revising certain tax expenditure provisions, however, the administration has proposed, for example, to revise the modified coinsurance provision, which has never appeared on any official list of tax expenditure items. Similarly, the special treatment of tax straddles, which was extensively revised by the Economic Recovery Act of 1981, was never listed as a tax expenditure. The fact that these provisions have not been listed as tax expenditures well illustrates the confusion that has arisen from considering tax expenditures as a list of tax reform items. The tax expenditure concept is a tool for budget review and analysis; tax policy review and analysis, on the other hand, need not and should not be limited to an examination of some, rather than all, of the provisions of the income tax code.

MEASURING TAX EXPENDITURES

Tax expenditure estimates are intended to show the cost of resource allocations caused by special tax provisions, and I think, it is important that we understand how they are measured with that purpose in mind.

To insure comparability between tax expenditure estimates and direct outlay estimates, tax expenditures must be measured in the same manner as are direct outlays. This requires that specific conventions be followed in measuring tax expenditures.

First, as with budget outlay estimates, tax expenditure estimates are made on the assumption that all other provisions of the tax code and all other laws governing market exchanges are unchanged.

Second, tax expenditure and direct outlay estimates are both based on the actual level of activities given the program; neither estimates what the level of the activity would be in the absence of the program. This is a particularly important point in the case of tax expenditure estimates, because they are often incorrectly assumed to be estimates of the revenue that would be gained if the special tax provision were repealed and thus do not take into account behavioral changes that would follow repeal of the special provision.

A second reason for the difference between revenue gains from repeal of provisions and tax expenditure estimates is the effect repeal would have on the aggregate level of income and economic growth. For example, all receipts as well as expenditure figures in the budget are based on projections of income and growth which assume the investment tax credit, as currently enacted, will continue to operate. If, however, the investment credit were repealed, or curtailed, without being replaced by a comparable investment incentive, the current projections of income and growth would have to be revised downward. Consistent with these revisions, receipts and expenditure projections would have to be also revised. The estimated net effect of repeal of the investment tax credit on receipts, therefore, would not be equivalent to the tax expenditure estimate shown in the budget.

Third, comparability with direct outlay estimates requires that tax expenditures be measured as "outlay equivalents." Most outlays in the Federal Government are measured in pretax dollars. That is, the outlay of the Federal Government is taxable income to someone. The measurement of tax expenditures in outlay equivalent form converts the after-tax dollars that the subsidy directly gives rise to into a pretax equivalent amount. For example, in the case of the $10 credit, if the average tax rate of recipients of that credit were 20 percent, the outlay equivalent of the $10 credit would be $12.50. If a $12.50 payment were made in place of the credit, the tax would be $2.50, leaving $10 after tax, the same amount as the credit. And that is the way we have measured the tax expenditures in special analysis G.

In addition to following these measurement conventions, adjustments must be made for the interactions between various tax expenditure provisions in order to make total tax expenditure estimates by budget function. I go into that point in some detail in my testimony, but I think I will skip over the interaction point here, Mr. Chairman.

There is one other aspect of the measure of tax expenditures that should be noted. Tax expenditure estimates are measures of the difference between the cost of resources allocated under current law and the cost of the allocation which would take place under the assumption that each tax expenditure provision had never been in effect. The estimates, therefore, generally show larger amounts than would be saved in the first years of transition to a tax law without one of the special provisions. This is analogous to the phaseout likely to accompany reductions in outlay programs as previously authorized and appropriated funds are spent.

RELATIVE EFFICIENCY OF TAX EXPENDITURES

Several factors must be considered to determine the efficiency of tax expenditures relative to other methods the Government uses to allocate resources in the economy to achieve public goals. Separate from the determination of the relative efficiency of methods, of course, a determination must be made of whether each program serves a useful public goal. Furthermore, there should be no illusion that somehow programs effected through the tax system are cheaper than other programs. This is one reason why it is so important to measure tax expenditures on an outlay equivalent basis.

One consideration in choosing a method to implement a program is the level of Government administration required for the program to be effective. If little or no Government administration is required, and other conditions described below are met, the program might efficiently be designed as a tax expenditure. An example of such a program is the investment tax credit. However, if a high level of Government involvement in the program is required, such as is true, for example, of many agricultural programs, a direct outlay program may be far more efficient.

A second consideration is the specific design of tax expenditure programs. Because of the graduation of income tax rates, an exclusion or deduction has more value to a high bracket taxpayer than to a taxpayer in a lower bracket. This is the reason, for example, that some of the benefits of the exclusion of interest on State and local bonds accrues to lenders. Credits, on the other hand, are of equal value to all taxpayers. Thus, generally, tax expenditure programs are more efficiently designed as credits, rather than as exclusions or deductions.

Third, the relative efficiency of a tax expenditure may depend on the group or activity which is to receive the subsidy. For example, many low-income individuals have no taxable income and, therefore, could only benefit from a tax credit if it were refundable. Further, to receive the refundable credit they would have to file an income tax return, which many would not otherwise have to do. A direct outlay or other program might, therefore, be a much more efficient way to reach such groups.

Fourth, it must be remembered that the normal provisions of the income tax code interact with, and therefore, affect the value of, tax expenditures. For example, an across-the-board rate cut changes the value of, that is the subsidy provided by, many tax expenditures. If a stable subsidy, or one that should not depend on tax rates and other features of the tax structure, is required for the efficient operation of the program, the program should not be framed as a tax expenditure.

A final consideration is that there is a hidden, although very real, cost involved in burdening the tax system with too many subsidy programs. Tax expenditures complicate the tax system for taxpayers and the Internal Revenue Service, and contribute to the view—whether or not well-founded—that the tax system is unfair. These compliance and perceived equity costs should be included in any assessment of the relative efficiency of tax expenditures.

BUDGET CONTROL OF TAX EXPENDITURES

Given the importance of tax expenditures as a method of allocating resources in the economy in order to achieve public goals, there is naturally concern within the administration and the Congress in exerting proper budget control over tax expenditures. At present, this control is exerted in several ways. Section 303 of the Budget Act prohibits the consideration of tax legislation effective for a fiscal year before the first budget resolution for that year has been adopted. Similarly, section 311 of the act prohibits tax legislation that conflicts with the revenue floor set by the second resolution. Section 308(a) requires that every bill or resolution that provides new or increased tax expenditures be accompanied by estimates for the current fiscal year and a 5-year projection. In addition, section 601 of the act requires a list of tax expenditures to be included in the President's budget, and similar lists are prepared annually by the Congressional Budget Office, under section 308(c) of the act, and by the staff of the Joint Committee on Taxation. These provisions provide some control, albeit indirect, over tax expenditures.

More importantly and directly, however, tax expenditures are consistently subject to review during consideration of major tax legislation. Most recently, as I have noted, there were substantial changes made in several tax expenditure items in the Economic Recovery Tax Act of 1981. In addition, changes in tax expenditure items are included in the administration's current tax proposals.

A number of proposals have recently been made to require more formal budget control procedures for tax expenditures, or to place explicit limitations on them. I believe these proposals are undesirable for several reasons. Changes in tax expenditure provisions should be based on long-run considerations of economic efficiency and equity, rather than on short-run budget considerations. Especially for those tax expenditures that concern long-term investments, such as housing and business plant and equipment, decisions are made for several years at a time and a stable set of tax laws is therefore essential.

REGULATIONS AND LOAN GUARANTEE PROGRAMS

Furthermore, other policy instruments in addition to direct outlays, such as regulations and loan guarantee programs, are alternative ways to achieve the objectives of tax expenditures. Each of these instruments is intended to allocate resources in the economy in order to achieve public goals. A possible consequence of limiting tax expenditures, therefore, might be to increase offbudget spending which is not subject to the same restraints under the Budget Act as are direct outlays.

It should also be noted that there is not universal agreement on the definition and measurement of tax expenditures. This lack of agreement is not critical to the current budget procedures for controlling tax expenditures. With an explicit limitation or more formalized control procedures, however, both the concept and the measurement of tax expenditures would have to be precisely defined. This would not be an easy task.

Even with precise definition and measurement of tax expenditures, however, severe difficulties would be encountered if an explicit limitation or more formalized control procedures were imposed on tax expenditures. One such difficulty is that the normal provisions of the income tax code interact with tax expenditure provisions. For example, when individual income tax rates are lowered or increased, the value of most tax expenditures changes. How would these changes be handled? A second type of difficulty would arise with some of the limitations that have been proposed, for example, limiting tax expenditures to a fixed percentage of net revenues. Such a limitation could be exceeded during a short-run downturn in economic activity. It would, therefore, become necessary to reduce tax expenditures or to increase taxes, and both steps might at that time be desirable.

TAX EXPENDITURES SHOULD HAVE REVIEW AND CONTROL

The conclusion to be drawn from such considerations is not, of course, that tax expenditures should be free from review and control. Instead, I conclude that because tax expenditures arise from special tax provisions, they are best reviewed and thereby controlled in the context of the entire tax code, including the normal as well as the special tax provisions. This review takes place currently during consideration of tax legislation. No further budget limitations or control procedures are required.

Mr. Chairman, that summarizes my statement. I will be happy to answer any questions.

Chairman DOMENICI. Thank you very much, Mr. Secretary.

PREPARED STATEMENT OF HON. JOHN E. CHAPOTON, ASSISTANT SECRETARY FOR TAX POLICY, DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of this Committee:

I am pleased to be here today to discuss tax expenditures. As I think everyone would agree, there are many provisions of the Internal Revenue Code specifically designed as incentives to encourage selected economic activities. These special tax provisions are commonly referred to as "tax expenditures," and I will therefore use this term in my testimony today. However, it should be noted that the label "tax expenditure" is misleading. Special tax provisions are not equivalent to direct Government expenditures on goods and services. Direct expenditures involve the purchase of labor, capital, and materials that are used directly by the Government to achieve public goals, such as national defense. In contrast, most special tax provisions provide a subsidy to an activity carried out in the private sector. For this reason, the label "tax subsidies" may better describe these special tax provisions than does the more conventional term "tax expenditures." But even the label "tax subsidies" is misleading, for many special tax provisions simply reduce disincentives in our tax Code. This is particularly true in the case of special tax provisions which have the effect of reducing the double taxation of corporate income.

The Administration is opposed to attempts to legislate blanket, across-the-board limitations on tax expenditures. Such limitations do not account for the different, sometimes highly-desirable, effect of different tax expenditures. Instead, this Administration is committed to a reevaluation of all Government activity in the economy, whether that activity is undertaken through direct outlay and subsidy programs, loan and loan guarantee programs, regulations, or through tax expenditures. Resources can be allocated to achieve public goals by each of these methods, and they must therefore be evaluated. But, that evaluation must deal with each program, regulation, or tax provision individually on its own merits. For example, a review of Government energy policy would be incomplete unless it covered energy tax expenditures (such as expensing of exploration and development costs, the excess of percentage over cost depletion, and various energy credits, which will total $8.8 billion in FY 1983), energy loan and loan guarantee programs (which will total $9.4 billion, net, in FY 1983), the cost of energy regulations (for example, price controls on natural gas and the 55 MPH speed limit, for which cost estimates are not included in the Budget), as well as direct outlays for energy (which will total $4.2 billion in FY 1983).

For Government management purposes, it is essential that the resource cost of Government programs be comparably measured, regardless of the particular method by which the allocation of resources is accomplished. The concept of tax expenditures was developed to provide such comparability between programs effected through special tax provisions and programs effected through other methods. Properly defined, measured, and applied, therefore, the tax expenditure concept can serve as a very useful management tool. Like many other concepts, however, it is subject to misuse as well as misunderstanding, and therefore has received some well-founded criticism.

In my remarks today, I will review the definition and measurement of tax expenditures, as well as some of the related concepts and measures that have been confused with tax expenditures. I will discuss the relative efficiency of tax expenditures as a method of achieving public goals. I will also discuss the control of tax expenditures under the Budget Act.

Defining Tax Expenditures

Section 3 of the Budget Act defines tax expenditures as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." This definition requires a distinction to be drawn between the special provisions of the tax structure, which are designed to to achieve public goals, and the normal provisions, which are necessary to make the tax system operational. Obviously, there are different ways to draw this distinction, a point to which I will return later. What follows, then, is the Administration's view of how this distinction should be drawn.

The normal provisions of the income tax include the definition of income subject to tax and allowable deductions, including some provision for the recovery of the cost of depreciable assets; taxable units and their threshold levels of taxability; the relationship between the taxation of corporations and their shareholders; the schedule of tax rates; the basic tax accounting rules, including the accounting period for taxation and whether income is taxed as it is realized or as it accrues; the treatment of international transactions; and the system of tax administration. Unlike the special tax expenditure provisions, these normal provisions are essential to the income tax.

In our view, for a provision to be special, two conditions must be met:

- The provision must apply to a narrow class of transactions or taxpayers; and
- There must be a general provision to which the special provision is a clear exception.

Some examples of tax expenditures, from Special Analysis G of the Budget, will illustrate this definition.

Under the general provisions of the income tax code, interest received from any source is includable in income subject to tax. However, a special provision allows interest on obligations of State and local Governments to be excluded from taxable income. The exclusion is therefore considered a tax expenditure intended to reduce the cost of borrowing for State and local Governments, even though some of the benefits accrue to lenders. A second example is the statutory exclusion of certain fringe benefits, such as employer-paid medical insurance premiums, from the taxable income of employees. The inclusion of wages in the tax base is a normal rule of the tax Code, and the exclusions of these fringe benefits are special provisions, and therefore constitute tax expenditures. Other examples of tax expenditures include special provisions that promote homeownership, exports, and employment of the handicapped.

Several features of the tax expenditure concept should be noted.

First, while the distinction between the normal and special provisions of the income tax may be clear in the abstract, in practice there is always difficulty in applying the distinction in order to delineate tax expenditures.

Second, the definition of tax expenditures should not be taken to suggest that the normal tax provisions involve no tax incentives or disincentives. All existing taxes affect economic incentives to some extent, and therefore the level and allocation of resources. In fact, some of the normal provisions of the income tax have effects very similar to special provisions.

A good example of this similarity is provided by the Accelerated Cost Recovery System (ACRS) rules and the investment tax credit. Any income tax requires a set of rules for determining how the cost of depreciable assets is recovered. The ACRS provisions now constitute the general income tax rules for that purpose. To see this, one need only ask: If ACRS is "special," what is the "general" rule in the Internal Revenue Code governing the recovery of cost of depreciable property to which ACRS is an exception? Absent some other general provisions, the ACRS provisions must be treated as part of the normal tax structure and therefore do not constitute a tax expenditure. In contrast, the investment credit is considered a tax expenditure because, unlike ACRS, it does not deal with one of the basic structural elements of an income tax.

Third, as I noted previously, there are other possible definitions of tax expenditures. It has often been suggested that tax expenditures be defined relative to the standard of an "ideal" income tax. However, there is no consensus among tax experts on the structure of an "ideal" tax relative to which special (tax expenditure) provisions could be delineated, and few would seriously regard an "ideal" tax as a practical tax structure. For example, under an "ideal" income tax, the rental value of owner-occupied housing would have to be added back (imputed) to homeowners' money income to arrive at the "ideal" income tax base. In addition, using an "ideal" income tax as a standard the double taxation of dividends at the corporate and individual levels would constitute a negative tax expenditure.

The more common approach to tax expenditures has simply been to list possible "tax reform" items. This approach has led to much confusion about the concept and measurement of tax expenditures. Further, neither the "ideal tax" or "tax reform" approaches has the pragmatic advantage of the definition used here and in Special Analysis G of identifying those provisions of the Internal Revenue Code that deal with basic structural features of the income tax, and those that provide special exceptions to those structural rules.

Fourth, the fact that a provision is a tax expenditure under this definition says nothing about the desirability or the effectiveness of the provision. This is also true, it should be noted, for direct outlay programs. The definition (and measurement) of tax expenditures is not a substitute for the analysis and evaluation of programs implemented through the tax system any more than a listing of direct outlays by program is a substitute for their evaluation. Further, the designation of a provision in the income tax Code as "normal" does not imply that the provision is desirable.

Clearly, there are many tax expenditures that serve desirable purposes in an efficient manner. The investment credit provides investment incentives for economic growth. The special tax treatment afforded pension savings, including IRA's and Keogh's, provide important incentives to save. Note that these provisions were expanded by the Economic Recovery Tax Act of 1981.

It is also clear that there are some undesirable tax expenditures and the Administration has proposed to repeal or modify them. Specifically, under our tax proposals the business energy tax credits would be repealed, corporations would be required to capitalize and amortize construction period interest and taxes on commercial structures, and certain restrictions would be placed on issues of tax-exempt bonds for private activities.

In addition to repealing or revising certain tax expenditure provisions, however, the Administration has proposed, for example, to revise the modified coinsurance provision, which has never appeared on any official list of tax expenditure items. Similarly, the special treatment of tax straddles, which was extensively revised by the Economic Recovery Tax Act of 1981, was never listed as a tax expenditure. The fact that these provisions have not been listed as tax expenditures well-illustrates the confusion that has arisen from considering tax expenditures as a list of "tax reform" items. The tax expenditure concept is a tool for budget review and analysis; tax policy review and analysis, on the other hand, need not and should not be limited to an examination of some, rather than all, of the provisions of the income tax Code.

Measuring Tax Expenditures

Tax expenditure estimates are intended to show the cost of resource allocations caused by special tax provisions. To insure comparability between tax expenditure estimates and direct outlay estimates, tax expenditures must be measured in the same manner as are direct outlays. This requires that specific conventions be followed in measuring tax expenditures.

First, as with budget outlay estimates, tax expenditure estimates are made on the assumption that all other provisions of the tax Code and all other laws governing market exchanges are unchanged. The same levels of aggregate income and economic growth that underlie direct outlay estimates are also assumed.

Second, tax expenditure and direct outlay estimates are both based on the actual level of activities given the program; neither estimates what the level of the activity would be in the absence of the program. This is a particularly important point in the case of tax expenditure estimates, because they are often incorrectly assumed to be estimates of the revenue that would be gained if the special tax provision were repealed.

Because of behavioral changes that may follow the repeal of a special tax provision, the revenue gain from repeal may be much lower than the tax expenditure estimate. An example would be the taxation of a particular employee fringe benefit which is currently untaxed, such as employer-paid medical insurance premiums. The expected response would be a decrease in the amount of employer-paid medical insurance premiums, but an increase in the amount of other still untaxed fringe benefits, such as employers' pension contributions and educational assistance. Thus, the revenue gain from the change would be less than the tax expenditure estimate, which only measures, quite correctly, the reduction in tax receipts from the actual level of employer-paid medical insurance premiums in the particular year. Note that there would be analogous behavioral responses if many direct outlay programs were eliminated or curtailed. For example, the removal of a price support for a particular agricultural commodity could be expected to lead to somewhat higher production of other, price-supported, commodities. In such cases, the net reduction in budget outlays would be lower than the savings from the eliminated (or curtailed) program.

A second reason for the difference between revenue gains from repeal of provisions and tax expenditure estimates is the effect repeal would have on the aggregate level of income and economic growth. For example, all receipts as well as expenditure figures in the Budget are based on projections of income and growth which assume the investment tax credit, as currently enacted, will continue to operate. If, however, the investment credit were repealed (or curtailed) without being replaced by a comparable investment incentive, the current projections of income and growth would have to be revised downward. Consistent with these revisions, receipts and expenditure projections would also have to be revised. The estimated net effect of repeal of the investment tax credit on receipts, therefore, would not be equivalent to the tax expenditure estimate shown in the Budget.

Third, comparability with direct outlay estimates requires that tax expenditures be measured as "outlay equivalents." Most outlays in the Federal Government are measured in pretax dollars. That is, the outlay of the Federal Government is taxable income to someone. Tax expenditures directly return income in the form of after-tax dollars in most cases. That is, a tax credit of $10 is a subsidy of $10 after taxes. The measurement of tax expenditures in outlay equivalent form converts the after-tax dollars that the subsidy directly gives rise to into a pretax equivalent amount. For example, in the case of the $10 credit, if the average tax rate of recipients of that credit were 20 percent, the outlay equivalent of the $10 credit would be $12.50. If a $12.50 payment were made in place of the credit, the tax would be $2.50 leaving $10 after tax, the same amount as the credit.

In addition to following these measurement conventions, adjustments must be made for the interactions between various tax expenditure provisions in order to make total tax expenditure estimates by budget function. These interactions may be demonstrated by comparing the result of deleting two tax expenditures simultaneously to that of deleting them separately.

In some cases, the reduction in tax expenditures from the deletion of two items simultaneously would be greater than the sum of the reductions from the deletion of the two items separately. This increase is due to "stacking" of the two items when they are taken together. For example, if interest income from State and local Government bonds were made taxable and capital gains on home sales were not deferred, more individuals would be pushed into higher tax brackets than if just one of these sources of income were treated under the normal rules of the tax Code; the combined reduction in tax expenditures would be greater than the sum of the two separate effects.

In other cases, the reduction in tax expenditures from the deletion of two items together would be smaller than the sum of the reductions considered separately. For example, if the deductibility of mortgage interest payments and homeowner property taxes were both repealed and the zero bracket amount (standard deduction) were left unchanged, more individuals who now itemize their deductions would opt for the zero bracket amount than if only one preference were repealed. The reduction in tax expenditures would therefore be lower from repealing both preferences together than the sum of the two estimates obtained from repealing each one separately.

Total tax expenditures for each functional category, such as national defense and energy, are shown in this year's Budget. In making the estimates, all of these interaction effects were taken into account. Note, however, that the Budget does not present a total of tax expenditures for all functional categories combined. This omission is not due to an inability to take all interactions into account for purposes of such a total. Rather, the omission is due to the fact that such a total carries little meaning. As noted above, tax expenditure estimates are based on the assumption that the programs are in place and that the level of aggregate income and growth are unchanged. These assumptions would clearly be wrong if all tax expenditure provisions were repealed. Further, tax expenditures represent only one method by which Government allocates resources in the economy to achieve public goals; a total for any particular method in isolation is therefore not very useful for Budget review and analysis.

There is one other aspect of the measure of tax expenditures that should be noted. Tax expenditure estimates are measures of the difference between the cost of resources allocated under current law and the cost of the allocation which would take place under the assumption that each tax expenditure provision had never been in effect. The estimates, therefore, generally show larger amounts than would be saved in the first years of transition to a tax law without one of the special provisions. This is analogous to the "phase-out" likely to accompany reductions in outlay programs as previously authorized and appropriated funds are spent.

Relative Efficiency of Tax Expenditures

Several factors must be considered to determine the efficiency of tax expenditures relative to other methods the Government uses to allocate resources in the economy to achieve public goals. Separate from the determination of the relative efficiency of methods, of course, a determination must be made of whether each program serves a useful public goal. Furthermore, there should be no illusion that somehow programs effected through the tax system are "cheaper" than other programs. This is one reason why it is so important to measure tax expenditures on an "outlay equivalent" basis. I will simply assume in the following that the usefulness and cost determinations have been made.

One consideration in choosing a method to implement a program is the level of Government administration required for the program to be effective. If little or no Government administration is required, and other conditions described below are met, the program might efficiently be designed as a tax expenditure. An example of such a program is the investment tax credit. However, if a high level of Government involvement in the program is required, such as is true, for example, of many agricultural programs, a direct outlay program may be far more efficient.

A second consideration is the specific design of tax expenditure programs. Because of the graduation of income tax rates, an exclusion or deduction has more value to a high-bracket taxpayer than to a taxpayer in a lower bracket. This is the reason, for example, that some of the benefits of the exclusion of interest on State and local bonds accrues to lenders, as I noted earlier. Credits, on the other hand, are of equal value to all taxpayers. Thus, generally, tax expenditure programs are more efficiently designed as credits, rather than as exclusions or deductions.

Third, the relative efficiency of a tax expenditure may depend on the group or activity which is to receive the subsidy. For example, many low-income individuals have no taxable income and therefore could only benefit from a tax credit if it were refundable. Further, to receive the refundable credit they would have to file an income tax return, which many would not otherwise have to do. A direct outlay or other program might therefore be a much more efficient way to reach such groups.

Fourth, it must be remembered that the normal provisions of the income tax Code interact with, and therefore affect the value of, tax expenditures. For example, an across-the-board rate cut changes the value of, i.e., the subsidy provided by, many tax expenditures. If a stable subsidy, or one that should not depend on tax rates and other features of the tax structure, is required for the efficient operation of the program, the program should not be framed as a tax expenditure.

A final consideration is that there is a hidden, although very real, cost involved in burdening the tax system with too many subsidy programs. Tax expenditures complicate the tax system for taxpayers and the Internal Revenue Service, and contribute to the view (whether or not well founded) that the tax system is "unfair." These compliance and perceived equity costs should be included in any assessment of the relative efficiency of tax expenditures.

Budget Control of Tax Expenditures

Given the importance of tax expenditures as a method of allocating resources in the economy in order to achieve public goals, there is naturally concern within the Administration and the Congress in exerting proper budget control over tax expenditures. At present, this control is exerted in several ways. Section 303 of the Budget Act prohibits the consideration of tax legislation effective for a fiscal year before the first budget resolution for that year has been adopted. Similarly, Section 311 of the Act prohibits tax legislation that conflicts with the revenue floor set by the second resolution. Section 308(a) requires that every bill or resolution that provides new or increased tax expenditures be accompanied by estimates for the current fiscal year and a five-year projection. In addition, Section 601 of the Act requires a list of tax expenditures to be included in the President's Budget, and similar lists are prepared annually by the Congressional Budget Office (under Section 308(c) of the Act), and by the staff of the Joint Committee on Taxation. These provisions provide some control, albeit indirect, over tax expenditures.

More importantly and directly, however, tax expenditures are consistently subject to review during consideration of major tax legislation. Most recently, as I have noted, there were substantial changes made in several tax expenditure items in the Economic Recovery Tax Act of 1981. In addition, changes in tax expenditure items are included in the Administration's current tax proposals.

A number of proposals have recently been made to require more formal Budget control procedures for tax expenditures, or to place explicit limitations on them. I believe these proposals are undesirable for several reasons. Changes in tax expenditure provisions should be based on long-run considerations of economic efficiency and equity, rather than on short-run Budget considerations. Especially for those tax expenditures that concern long-term investments such as housing and business plant and equipment, decisions are made for several years at a time and a stable set of tax laws is therefore essential.

Furthermore, other policy instruments in addition to direct outlays, such as regulations and loan guarantee programs, are alternative ways to achieve the objectives of tax expenditures. Each of these instruments is intended to allocate resources in the economy in order to achieve public goals. A possible consequence of limiting tax expenditures, therefore, might be to increase off-budget spending which is not subject to the same restraints under the Budget Act as are direct outlays. In certain areas, tax expenditures might even be replaced by Government regulations in order to achieve the same or similar objectives.

It should also be noted that there is not universal agreement on the definition and measurement of tax expenditures. This lack of agreement is not critical to the current Budget procedures for controlling tax expenditures. With an explicit limitation or more formalized control procedures, however, both the concept and the measurement of tax expenditures would have to be precisely defined. This would not be an easy task.

Even with precise definition and measurement of tax expenditures, however, severe difficulties would be encountered if an explicit limitation or more formalized control procedures were imposed on tax expenditures. One such difficulty is that the normal provisions of the income tax Code interact with tax expenditure provisions. For example, when individual income tax rates are lowered or increased, the value of most tax expenditures changes. How would these changes be handled? A second type of difficulty would arise with some of the limitations that have been proposed, for example, limiting tax expenditures to a fixed percentage of net revenues. Such a limitation could be exceeded during a short-run downturn in economic activity. It would therefore become necessary to reduce tax expenditures or to increase taxes, steps which could prolong and deepen the downturn. Another difficulty with measures that would focus attention on "special" tax provisions, however defined and measured, is that it would take attention away from all other tax provisions. Thus, there would be a real danger that provisions such as those that allowed tax straddles would persist in the tax Code.

The conclusion to be drawn from such considerations is not, of course, that tax expenditures should be free from review and control. Instead, I conclude that because tax expenditures arise from special tax provisions, they are best reviewed and thereby controlled in the context of the entire tax Code, including the normal as well as the special tax provisions. This review takes place currently during consideration of tax legislation. No further Budget limitations or control procedures are required.

Summary

Tax expenditures are one method by which the Government allocates resources in the economy in order to achieve public goals. Many tax expenditures, such as the investment credit and those that encourage pension savings, serve important public goals in an efficient manner. Others, such as the business energy credits, are less desirable and should be repealed.

The concept of tax expenditures, properly defined, measured, and applied, is a useful tool for Budget analysis and control. The concept should not be confused with tax reform proposals, nor should estimates of tax expenditures be taken as equivalent to revenue gains from repeal.

The efficiency of tax expenditures relative to other methods of implementing programs depends on the required level of Government program administration, whether the tax expenditure is in the form of an exclusion or deduction rather than a credit, the specific group or activity the program will subsidize, the effect of other tax provisions on the tax expenditure, and the effect of the tax expenditure provision on income tax compliance costs and the perceived equity of the tax system.

While there has been some interest in imposing an explicit limitation or additional controls on tax expenditures, they would be difficult to implement and could seriously interfere with the desirable incentives provided by some tax expenditures.

I will be pleased to answer any questions you may have.

Chairman DOMENICI. When is the report from the Treasury Department on the Safe Harbor Leasing coming up to the Hill?

Mr. CHAPOTON. It will be available not later than the end of this month.

Chairman DOMENICI. No later than the end of this month?

Mr. CHAPOTON. Yes, sir.

Chairman DOMENICI. I understand Treasury expects the study to show that a lot of small companies are taking advantage of this provision. Is that correct?

Mr. CHAPOTON. Our preliminary review shows that a lot of small companies are using it. A lot are the old straight leases, not the regular, what we call leveraged leases where the financing is provided by the lessor and not the lessee. So that requires further analysis.

Chairman DOMENICI. Are you are going to distinguish those two for us?

Mr. CHAPOTON. Yes; we are distinguishing those two.

Chairman DOMENICI. You are the Secretary for policy; is that correct?

Mr. CHAPOTON. Yes, sir.

TREASURY POSITION ON SAFE HARBOR ACT

Chairman DOMENICI. It appears that Treasury is taking the position that we should not modify Safe Harbor Leasing. I would just say to you that a couple more of these GE stories, and leasing is going to go.

It is my understanding that one of the reasons that leasing was recommended was because there were certain capital-intensive American industries—mining, for one—that needed tax relief to remain competitive and to avoid the recent outbreak of corporate mergers.

They had recommended refundability as a way to allow them to share in the tax benefits to be made available to profitable companies. If I am wrong on this, you correct me. Instead, this new leasing provision would be developed to avoid refunds. If I am correct, then how do we explain today's $100 million refund to GE?

Mr. CHAPOTON. Mr. Chairman, the tax leasing provisions were originated in my office. We were concerned, early on when we reviewed the effect of the Accelerated Cost Recovery System or any greatly increased cost recovery which was then being considered by the Ways and Means Committee, that we would have a greater disparity between companies, the cost of equipment for companies, at current tax liability, and those who did not. We were concerned that not only does that cause inefficiency and disparity in the cost between these companies, but it would lead to tax-motivated mergers.

We looked around for a way to deal with this problem. We knew that if nothing were done, that the leasing done under old law would have a lot more pressure on it, and there were a lot of problems in the leasing rules under the old law. So the approach we followed was to liberalize the leasing rules.

Now, at the same time, a number of industries had approached us about making the tax credit refundable. Our work had preceded that. We pointed out to them and to others who came in under refundability that the problem came in under both the credit and cost recovery, and we wanted a provision for both of the incentives to capital.

KNEW TAX LIABILITY WOULD BE REDUCED

Chairman DOMENICI. Mr. Secretary, did you expect that to occur?

Mr. CHAPOTON. Mr. Chairman, yes, you have to say that you knew that the purchasers of the credit and cost recovery, the lessors were going to reduce their tax liability significantly.

The article also points out that GE paid $400 million for that benefit, that $300 to $400 million went to companies that could not otherwise use the tax benefit.

Chairman DOMENICI. I understand. I just want to make sure that this result did not catch you unexpectedly, that is all I am asking.

Mr. CHAPOTON. No, I cannot say that it caught us unexpectedly.

I am concerned about the perception problem that that generates and it is something that we are looking at.

Chairman DOMENICI. Mr. Secretary, as the tax policy man in Treasury, are you concerned about the complexity of the tax law and the sentiment of the American people as to its complexity and inequity?

Mr. CHAPOTON. Absolutely.

Chairman DOMENICI. Do you have any way of measuring that; is that getting better or worse, in your opinion?

Mr. CHAPOTON. I think complexity, while we are more conscious of it than we were a decade ago, in certain areas is improving and other areas it is getting worse.

Chairman DOMENICI. How about inequity? Do you have any sense of what the American people think about the tax structure? Is it treating people fairly or not?

Mr. CHAPOTON. I do not know; we do not try to measure it, but we are concerned about it. I think it is an important consideration.

We have a self-assessment procedure. So the perception of equity is exceedingly important and that is one of the problems we have with these leasing rules.

Chairman DOMENICI. I do not expect you to answer this question unless you know; but I am pleased to note that your boss, the Secretary, endorsed balancing the budget.

I wonder if you know whether he is contemplating that it be balanced constitutionally or otherwise?

Mr. CHAPOTON. I do not know. He did so again this morning on TV.

REVIEW TAX EXPENDITURES FOR RAISING REVENUES

Chairman DOMENICI. Mr. Secretary, I understand there are different shades and colors in tax expenditures, but what if the Congress said, in order to move more dramatically toward a balanced budget, we are going to raise revenues by $30 billion in 1983, $40 billion in 1984, and $50 billion in 1985.

Now, forget all these distinctions you try to make, would you recommend in a general way that that be done by increasing tax rates for all individual taxpayers or would you recommend that we look at the tax expenditures?

Mr. CHAPOTON. I think, Mr. Chairman, you would look, and if you give that direction to the tax writing committee, the Finance Committee, it will look at both possibilities but as your question points out, review of tax will put more pressure on review of tax expenditures. And that is not inappropriate. Those should be reviewed by tax policy people at our end of the street and the Finance Committee as well.

The question would be whether you want to increase taxes in specific areas. I do not think I can answer whether you——

Chairman DOMENICI. Let me be more specific.

Would you recommend looking at the tax expenditures or changing the 5-10-10 personal income tax reduction if the Finance Committee was instructed to raise revenue and they asked for your advice?

Mr. CHAPOTON. I believe we would review the tax expenditures as we do anyway, but we would review them. We want to keep the 5-10-10—you mean the individual tax cuts?

Chairman DOMENICI. Yes.

Mr. CHAPOTON. I think we would definitely keep those in place.

Chairman DOMENICI. Would you would prefer to look at the tax expenditure side first?

Mr. CHAPOTON. Because we would look at a number of items in the code and many, if not most of those would be on the tax expenditure list. Some would not be, as I pointed out. The straddles were not on the list nor was modified coinsurance.

Chairman DOMENICI. I do not think these lists include every tax expenditure, such as tax straddles. I do not think that makes any difference whether a tax preference is on the list or not. You are still talking about a tax preference. You call it one thing; others may call it something else.

TAX EXPENDITURE LIST SERVES USEFUL PURPOSE

Mr. CHAPOTON. My only point is that I think the tax expenditure list serves a useful purpose in showing how the Government allocates resources and to use it as tax reform-type proposals is probably not as useful as the entire Internal Revenue Code.

Chairman DOMENICI. In that regard, you disagree with Charls Walker?

Mr. CHAPOTON. Yes, I disagree to the extent I think it is a useful device that Government needs to know what it is doing in specific areas and the tax expenditure analysis is helpful.

Chairman DOMENICI. And you also disagree with Mr. Walker in that you would look at removing certain tax expenditures before you would defer or get rid of the individual tax cut, right?

Mr. CHAPOTON. That is correct. We want to keep a lower rate of tax on individuals, that is the basic point of the President's program so we would look elsewhere.

Chairman DOMENICI. Mr. Walker seems to think that you should leave the tax reductions for business in place and defer those for individuals. He must believe that business tax reductions are better for American growth than the indivivual tax cut. Do you agree or disagree.

Mr. CHAPOTON. Well, it is quite hypothetical. I do not want to prejudge what Mr. Walker is thinking but I will repeat that we think that the individual cuts are an essential part of our economic package and so we would look elsewhere.

Chairman DOMENICI. Well, what else could he mean, if he says leave the business cuts alone and defer the individual? What would he have in mind?

Mr. CHAPOTON. It sounds as though he would mean going to the individual, reducing the individual rate reductions.

Chairman DOMENICI. It sounds like he must think that that would be the better of two choices; does it not?

Mr. CHAPOTON. Yes; it does.

Chairman DOMENICI. He generally propounds his theories on the basis that we need to help American business capitalize and grow again; does he not?

Mr. CHAPOTON. Yes.

Chairman DOMENICI. Would it not be logical to assume that he thinks that is more important than the individual, for that purpose?

Mr. CHAPOTON. Mr. Chairman, they are both important, but he is, as you stated, I believe he is putting the investment incentive ahead of immediate individual tax cuts.

As I understand it, he would not eliminate the individual tax cuts but simply defer them for another year or two.

TAX EXPENDITURES INCREASED BY $82 BILLION

Chairman DOMENICI. My staff tells me that the 1981 Economic Recovery Tax Act increased tax expenditures in fiscal years 1982 through 1984 by $82 billion.

Have you done any analysis so that you could tell us whether that is the case or not?

Mr. CHAPOTON. No; I have not. Those figures were done by the Congressional Budget Office, acclerated cost recovery system as a tax expenditure, so that would be a large part of that total. Obviously ACRS that was a large part of our program last year and other items, such as the credit for research and development. I would not quarrel with that figure. We would have to go back and analyze it.

Chairman DOMENICI. Mr. Secretary, were you in the same position when the President sent his first tax bill up and when we went through a 2½ month delay where nobody did anything and when a bidding war erupted? Were you in on that?

Mr. CHAPOTON. Yes; I was.

Chairman DOMENICI. How much of that $82 billion was in the President's first package; do you remember?

Mr. CHAPOTON. I would say offhand, I, of course, would have to break it down, but the largest overall portion would be attributed to the ACRS. So I would imagine that most of them would be in the original package but I would have to look further.

Chairman DOMENICI. Maybe you could check that for us, just for the record.

Mr. CHAPOTON. I would be happy to.

[The following was subsequently received for the record:]

Increase in Tax Expenditures Due to Economic Recovery Tax Act

The $82 billion figure referred to by Chairman Domenici is the Congressional Budget Office's (CBO) estimate of the increase in tax expenditures over the 1982-84 period due to the Economic Recovery Tax Act of 1981. Of this amount, $1 billion is attributable to the reduction in corporate tax rates, $13.9 billion to the deduction for two-earner couples, and $52.6 billion to the accelerated cost recovery system. The Administration does not regard these items as tax expenditures, but rather as a part of the reference, or structural, income tax system; that is, they constitute a part of the general rules for determining taxable income and tax liabilities, and not special, or preferential, items. Thus, using the CBO estimates but the Administration's definition of tax expenditures, the Economic Recovery Tax Act of 1981 increases tax expenditures by only $14.5 billion. Note, however, the $82 billion figures does not include an estimate of the reduction in the value of tax expenditures due to the individual tax rate reductions, and so is overstated.

Tax expenditure estimates prepared by CBO cannot be directly compared with those provided in Special Analysis G of the budget, because the two sets of numbers are measured on different bases. CBO's estimates are of the tax losses from tax expenditures, whereas the Special Analysis G figures are outlay, or direct expenditure, equivalents. Outlay equivalent estimates indicate the value of resources directed to particular activities rather than taxes "lost" due to certain subsidies.

The President's original income tax program consisted of personal tax reductions and a capital cost recovery program. Therefore, of the $82 billion, $52.6 billion, or 64 percent, is attributable to provisions similar to those proposed by the Administration.

Chairman **Domenici**. I think it is 30 to 40 that were not.

Mr. **Chapoton**. Thirty to forty percent that were not?

Chairman **Domenici**. Billion.

Mr. **Chapoton**. Oh, billion? I will be happy to do that, yes, sir.

Chairman **Domenici**. I would only give you that $82 billion for comparison.

Mr. **Chapoton**. Yes; we measure them differently. We measure them in terms of outlay equivalent and we have not listed in our tables, ACRS as a tax expenditure. We do have the ACRS figure, though. We do not list it as a tax expenditure because we have no other cost recovery system against which to compare it as a tax expenditure. But, we can work from the figures that the Congressional Budget Office has used.

Chairman **Domenici**. I think it is imperative that people in your position of suggesting tax policy have at least some familiarity with what is going on on the outlay budget side of the budget.

I gave you this number, just so you will know the predicament that we find ourselves in. If the $82 billion figure is true, then 63 percent of all the budget cuts we have made for fiscal years 1982 through 1984 were offset by tax reduction amendments from the bidding war which were never in the President's recommendation. That is one step forward and two-thirds back in terms of Secretary Regan's desire to have a balanced budget.

Mr. **Chapoton**. Well, I understand. I think we would have to be careful in comparing those figures for the reasons I state in our testimony but it is unquestionably true that at a time of budget constraint you do need to review, carefully, special tax provisions in the code. We do not have any disagreement on that point.

ONGOING GROUP REVIEWS STRUCTURAL CHANGES

Chairman **Domenici**. My last question is: Do you have a group working on tax simplification and tax reform as an ongoing activity?

Mr. **Chapoton**. We—I must say, it has not been too active lately because of the activity in the tax field generally—but we do have an ongoing group that reviews structural changes that we think would be desirable, which most people would prefer. Tax reform and simplification is an item that is always foremost in our minds. When it finally works its way through the system, however, it does not always show up that way.

Chairman **Domenici**. Now, Mr. Secretary, I previously posed a hypothetical question as to how you would raise $30, $40, and $50 billion in new revenue over the next 3 years. I only offered you two choices: the 5-10-10 personal tax cut and tax expenditures. I do not want to be unfair with that question.

I assume that you would remain firm that the 5-10-10 cut should remain, and I forced you to say that you would look at tax expenditure reductions. I do not want the record to appear as if you had no other suggestions.

I just would state again that the individual tax cuts are essential elements of the program. If we were directed to raise taxes we would look elsewhere.

Senator Chiles.

Senator **Chiles**. Mr. Secretary, I find your statement kind of odd. You present a lot of reasons why tax expenditures are equivalent to direct spending and you say that when we judge every area of Federal policy, we ought to look at the tax and spending policies together. But when it comes to the bottom line, you say we should not look at the total cost of tax expenditures or limit them in any way.

However, when it comes to spending, the bottom line is what counts most. In the administration's budget and in the Budget Committees work, we often say that while most expenditures look good, and certainly they are good for somebody, we just cannot afford the total cost and so we have to limit some of those spending items.

How can you say that the bottom line for direct spending is so important that we have to make some limitations and yet not for tax expenditures?

TAX EXPENDITURES MUST BE REVIEWED INDIVIDUALLY

Mr. **Chapoton**. Well, the point I am trying to make is that—let us call it tax expenditures or special tax provisions, which is more descriptive, must be reviewed individually as outlays must be reviewed individually and I understand the function of this committee sometimes does not have the option or the charge to do that and must speak in terms of overall figures. In that event then, you have to turn to not what we see as the budget tax expenditure list but we must turn to what the revenues, how revenues would be affected by changes in certain tax provisions and that would be, I assume a function of the tax-writing committees.

And if we are working with the wrong figures, it is one point. But the other point is I am saying they have to be looked at individually.

Senator **Chiles**. Well, having looked at tax expenditures individually, you do not seem to have come up with any that we can eliminate. The administration comes up with the expenditures that the Budget Committee can eliminate.

Mr. **Chapoton**. On the contrary, we have proposed some changes in items that appear on the tax expenditure list and some that do not. We proposed energy credits, for example, and proposed one not on the list, modified co-insurance. We have reviewed items to see if they should be eliminated or modified and have made proposals as a result.

Senator **Chiles**. Well, in that review you came up with about $14 billion in tax expenditure limitations as opposed to $58 billion for spending. So it looks to me that you are still looking at it in a different way.

Mr. **Chapoton**. Well, that is correct. The pressure is on the spending side.

Senator **Chiles**. All your reasons for not limiting tax expenditures seems to me to have an exact equivalent in the direct spending. If we cut one welfare program, we can get either increases or decreased cost in other programs. If we cut AFDC, we lower medicaid but raise the cost of food stamps. We also have the same line-by-line review conducted by authorizing committees but they cannot control the total.

Finally, then businesses and individuals and State and local governments like to have the same kind of certainty about spending that you say we need about taxes.

TAX EXPENDITURES VARY

Mr. CHAPOTON. Well, Senator, the point still is that tax expenditures vary. I am addressing my question to an overall limit in my testimony, to overall limits of tax expenditure as a ceiling, some type of ceiling, percentage of receipts, that type of thing. They vary to such a great degree that I think that overall limits are not very helpful. I mean, they vary from the investment tax credit to the nontaxability of social security. It seems to me that if more revenues are needed, the charge should be more revenues and one should then review the tax code to see how best to raise those revenues. But I do not think it is helpful to look at tax expenditures as some one group of items that are ideal for raising revenues across the board. They have such different effects as the two I mentioned: social security and the investment tax credit.

So I think an overall limit does not make any sense in that area.

Senator CHILES. That is all.

Chairman DOMENICI. Mr. Secretary, we appreciate your joining us. Obviously we are going to have to begin that difficult job of matching up both sides of the budget. We do not have the jurisdiction to determine what the mix of tax policies will be. We only set the overall levels.

I think it has been valuable for us to hear your views on tax issues as a policymaker in Treasury because we have to set the tax levels in the budget resolution. You have been very helpful in explaining positions of the Treasury Department, and we appreciate your being here.

Thank you very much:

Mr. CHAPOTON. Thank you, Mr. Chairman.

Chairman DOMENICI. All right. Our next witnesses are a panel including Dr. Emil Sunley, director of tax analysis at Deloitte Haskins & Sells; Dr. Charls E. Walker, chairman, American Council for Capital Formation; and Jerome Kurtz, senior partner, Paul, Weiss, Rifkind, Wharton & Garrison.

I understand that Dr. Walker is testifying before another committee and will be here shortly. So we will proceed with the other two panelists, and he will join us shortly.

I have a prepared statement. I won't read it, but will, without objection, put it in the record.

PREPARED STATEMENT OF CHAIRMAN DOMENICI

This morning we have an eminent panel of tax experts with us to discuss the tax expenditure budget. Dr. Emil Sunley is the Director of Tax Analysis for Deloitte, Haskins, and Sells. He served 11 years as an economist at the Treasury Department, where he was most recently Deputy Assistant Secretary for Tax Policy in charge of the Office of Tax Analysis. He has published numerous studies on the economic effects of tax policy, including recent articles on safe harbor leasing and the proposed alternative corporate minimum tax.

Dr. Charls Walker is Chairman of Charls Walker Associates and served as Deputy Secretary of Treasury and as Executive Vice President of the American Bankers Association. Currently, he is Chairman of the American Council for Capital Formation and is a member of President Reagan's Economic Advisory Board. He has played a key role before the Congress and the administration in promoting capital formation through recent changes to the depreciation and capital gains tax laws.

Mr. Jerome Kurtz is a partner with the law firm of Paul, Weiss, Rifkind, Wharton and Garrison. He has served as Commissioner of the Internal Revenue Service and as Tax Legislative Counsel at the Treasury Department. He has guided much tax legislation through the Treasury and the Congress and brings valuable experience on administering the tax laws.

Gentlemen, we are here this morning to discuss tax expenditures. This raises questions of what should be included in the tax expenditure budget, how useful the concept is in comparing tax policy with spending policy, and whether there should be tax expenditure control under the Budget Act. This year these issues have focused upon administration changes to its tax expenditure budget and upon safe harbor leasing and the proposed alternative corporate minimum tax. Your discussion of these specific issues in the context of the broader principles of tax policy will be of great interest to us.

Your statements will be included in the record. Each of you may take ten minutes to highlight your testimony, and then we will proceed to questions.

Chairman DOMENICI. Mr. Kurtz, why don't we start with you.

STATEMENT OF JEROME KURTZ, PARTNER, PAUL, WEISS, RIFKIND, WHARTON & GARRISON

Mr. KURTZ. Thank you, Mr. Chairman. I am a lawyer in private practice in Washington, D.C. From 1977 to 1980 I was Commissioner of Internal Revenue. Today I appear in my individual capacity in response to your invitation to participate in this hearing on the very important subject of tax expenditures.

You have asked for my general assessment of the utility of tax expenditures and, in addition, for my views of several specific questions: Are tax expenditures as efficient as direct outlays in promoting economic and social objectives? Should tax expenditures be subject to control under the Budget Act? Is there need for change in the definition of tax expenditures?

Mr. Chairman, I would like to summarize parts of my statement and submit my full written statement for the record.

Chairman DOMENICI. It will be made a part of the record.[1]

Mr. KURTZ. Thank you.

PROLIFERATION OF TAX EXPENDITURES

Obviously, anyone involved in tax administration must be deeply concerned about the effect of the proliferation of tax expenditures on our tax system.

There are several effects of tax expenditures. First, high marginal rates. When we narrow the tax base by creating widespread deductions we are obviously compelled to raise marginal rates.

Second, something that was mentioned previously, is the fairness of the system: Because various deductions and credits do not fall evenly among taxpayers, there are some taxpayers who are benefiting, thereby paying little or no income tax. Others, who do not so benefit, are severely disadvantaged by the system and perceive it is unfair. And third, but certainly not least, is the effect of tax expenditures on complexity.

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[1] See p. 259.

Our system today is much too complex, It is beyond the comprehension of the average taxpayer. Yet if one looks at a tax return, the regular 1040 tax return that we all file, line by line, one can see that perhaps three-quarters of the lines on the tax return are attributable to specific tax expenditure items. Perhaps three-quarters of the instructions are attributable to tax expenditure items and the cumulative total creates a system which, as I say, is beyond the ability of most taxpayers who are required to comply with that system. These three factors, high marginal rates, the perception of unfairness in the system, and its complexity, all have adverse effects on compliance. And compliance with our individual income tax system today is a serious problem.

When we look at a tax expenditure we have to think not only of the effect it has on the specific policy which is being implemented, but also on its effect on the tax system as a whole. And that effect is a very profound one.

EFFECT OF TAX EXPENDITURES ON SPENDING POLICY

In addition to the effect tax expenditures have on the tax system, is the effect that the widespread use of tax expenditures have on spending policy. Stated simply, because we finance programs and projects both by direct spending and through tax relief provisions there is no rational system in existence today for setting and carrying out national priorities. This is a problem of increasing magnitude.

In 1967, the tax expenditure budget contained 50 items with a revenue loss of $36.6 billion. This represented 20.5 percent of total direct Federal spending. By 1981 tax expenditures had risen to 34.6 percent of direct spending and their number had doubled.

While direct spending is being reviewed under a microscope in an attempt to narrow our huge projected deficits, over $250 billion of spending through the tax system has been largely ignored. Government programs to provide low-income housing are being cut to the bone or eliminated. At the same time the tax system is providing over $45 billion in subsidies for home ownership—including tax expenditures to subsidize second and third homes.

Is it logical to scrutinize the medicaid program and ignore the deductibility of medical expenses allowed to the more affluent? We need a budgetary process that requires all Government programs to be considered together; that requires program priority be set for the entire budget—both direct spending and tax spending.

I am not suggesting that the answer in such consideration will always be to eliminate the tax expenditures, but only that the budget process consider the entire budget—not just three-quarters of it.

I do not feel in a position to recommend a particular congressional procedure to accomplish this coordination, but I would strongly recommend that such coordination be implemented within the Executive branch. Executive departments, in compiling their budget requests, should be charged with tax expenditures in their areas of responsibility. In their program recommendations, they should have the ability to recommend substitution of direct programs for tax expenditures or the reverse. But they should not be in the position, as they are now, to favor tax incentives over direct programs because the former are not charged to their budget.

CHANGE THE WAY THE ACT IS BEING INTERPRETED

You have asked whether there is any need to change the definition of "tax expenditures." The only needed change, I believe, is a change in the way the existing act is being interpreted by the administration.

I believe that the definition contained in the Budget Reform Act of 1974 is quite clear, particularly when the legislative history of that act is taken into account and when the statutory language is considered against the background of tax expenditure budgets which existed at that time, and were considered in formulating the language of that act. Notwithstanding this history and consistent precedent, Special Analysis G to the 1983 budget changes the definition in a way which clearly violates the 1974 Budget Reform Act. One result of this change is that the revenue loss attributable to the accelerated cost recovery system is not reflected as a tax expenditure. The explanation for this change contained in Special Analysis G is entirely unconvincing and leaves the whole issue of the definition of tax expenditures in a muddle.

The explanation basically is that if there is only one way to claim a certain deduction that method is not a tax expenditure, that there must be an exception to a general rule. The general rule in our income tax however is to tax income, and income is not a completely evasive concept. Economists generally agree on what income is; accountants generally agree on what income is. Certainly there are problems around the edges as there will be with any definition but the core issues are not subject to debate.

Tax expenditures are a tool for analysis and do not in themselves represent policy judgments. It is therefore particularly unfortunate that the administration has chosen to distort the definition of tax expenditure for what apparently is its own political end.

That ACRS is a tax expenditure is unquestionable. It provides for recovery of costs by a method which bears no relationship to either economic depreciation or depreciation as measured by accountants. Moreover, within the ACRS provisions themselves, the extraordinary nature of the deduction is recognized by providing for more conservative cost recovery allowances in computing earnings and profits for purposes of determining the taxation of dividend distributions.

Finally, you have asked me to comment on various tax proposals that have been put forward by the administration and others.

In general, let me say the administration's proposals, by and large, address important areas. Whether the solutions proposed are the appropriate ones, I am not in a position to comment, not having studied them in sufficient detail, and in some cases not being sufficiently familiar with the industries involved.

CORPORATE MINIMUM TAX PROPOSAL

I would however like to make a comment on the corporate minimum tax proposal. This proposal raises the basic question of using a minimum tax to attack, in a halfhearted way, unwarranted tax expenditures. It would obviously be preferable to address each of these items of tax preference individually, and where the tax subsidy is found to be too generous, cut back or eliminate the subsidy itself. Creating an alternative tax system results in enormous complexity, difficulty in planning and inconsistent tax treatment of corporations depending on the range of their activities. While it moves in the right direction, it does not get at the heart of the problems which it addresses.

There have been numerous suggestions to reduce or defer individual tax cuts legislated by the Economic Recovery Tax Act last year.

The individual tax reductions which were legislated represented, for the most part, reductions necessary to mitigate the effects of inflation on our progressive tax system. Even with these cuts, the overall effective tax rates through 1984 will remain essentially unchanged from what they were in 1980. Unfortunately, the lowest income taxpayers will still have tax increases during that period with reductions going to the highest income taxpayers. This comes about because of the legislated increases in social security taxes, the fact that no increases were legislated in exemption levels and the disproportionately large decrease in the maximum rate. This distortion in relative tax burdens is exacerbated by the fact that spending cuts will have a profound impact on lower income households. For example, the legislated decreases in cash and in kind benefits for 1984 will be $18 billion, almost half of which will come from households with under $10,000 income. Deferring the individual cuts will only make these problems worse.

REEXAMINE ACRS

While there have been numerous suggestions to modify or repeal the safe harbor leasing provisions of the Economic Recovery Tax Act, little attention has been paid to ACRS itself. While the leasing provisions present their own set of problems—compounding and exaggerating the difficulties of coordinating tax expenditures with direct expenditures—they are a symptom of the basic problem rather than the problem itself.

If the ACRS benefits were not as rich as they are, the pressure to create a transfer mechanism would diminish. But the benefits are indeed rich and will result in tax losses for large numbers of corporations.

The current Economic Report of the President contains a table which shows the historic before-tax rates of return on new investment required to produce an after-tax rate of return of 4 percent. For general industrial equipment for the years 1975 to 1979 the pretax rate of return required was 6.4 percent. For 1985 it will be 2.7 percent. That means that the tax benefits under ACRS will not only eliminate the tax on new investment but will supplement the rate of return, increasing it from 2.7 percent to 4 percent.

I might repeat that this table and analysis comes from the President's economic report and does take into account the effect of inflation as projected under the budget.

When we create a cost recovery system which provides negative tax payments, company to company distortions become severe, and hence the pressure on leasing.

In my view, leasing should be reexamined in the context of a reexamination of ACRS.

I would look first to the corporate tax reductions to provide the revenue necessary to lessen our budget deficits and to restore some semblance of equity to our tax system.

Thank you.

Chairman DOMENICI. Thank you.

PREPARED STATEMENT OF JEROME KURTZ, PARTNER, PAUL, WEISS, RIFKIND, WHARTON & GARRISON

Mr. Chairman and Members of the Committee:

My name is Jerome Kurtz. I am a lawyer in private practice in Washington, D.C. From 1977 to 1980 I was Commissioner of Internal Revenue. Today I appear in my individual capacity in response to your invitation to participate in this hearing on the very important subject of tax expenditures.

You have asked for my general assessment of the utility of tax expenditures and, in addition, for my views of several specific questions: Are tax expenditures as efficient as direct outlays in promoting economic and social objectives? Should tax expenditures be subject to control under the Budget Act? Is there need for change in the definition of tax expenditures?

Anyone involved in tax administration must be deeply concerned about the proliferation of tax expenditures. Last year I wrote a short article in which I discussed what I considered the most pressing tax administration problems.

High on that list was the problem of the complexity of our tax system, and at the heart of that complexity are tax expenditures.

I would like to repeat what I said there:[1]

> Everyone recognizes that our tax laws are too complex. Yet not only has there been no progress toward simplification in recent years but the law has become still more complicated. We cannot hope for a tax law that completely avoids complexity. Our economic system, with all its variety and complexity, would be ill served by the rigidity that overall simplicity in the law would require. Simple rules cannot be devised to compute fairly the taxable income of multinational corporations or generation-skipping trusts in all the variety of forms that our economy and family plans present. But most taxpayers have relatively simple economic lives. They are not involved in complex transactions. Yet for most of these 100 million taxpayers our tax laws have become unnecessarily complex.
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> Complex laws produce confusing forms and difficult instructions. While the Service has done a remarkable job in designing forms and writing instructions, there are real limits on the extent to which forms and instructions can be simplified and still reflect the law accurately. The complexity of the tax laws also diminishes the ability of the Service to give accurate advice to taxpayers and to conduct examinations effectively. People with abilities equal to the task of mastering the complexity are scarce and providing them with adequate training is difficult and costly.
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> The goal of an income tax law should be to provide rules to determine income for the purpose of measuring one's ability to pay tax. But much of the complexity of our income tax arises not from provisions necessary to measure ability to pay tax, but rather from provisions in the tax code designed to encourage

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[1] Kurtz, Notes to a New Commissioner of Internal Revenue, Tax Notes, June 1, 1981.

or reward taxpayers for making particular kinds of investments or expenditures. The 1982 budget contains a Special Analysis which lists about 100 such tax expenditures, a number which has grown significantly in recent years.

While the goals sought to be achieved by some of these tax expenditures may be desirable, too little attention has been paid to the complexity they add to the tax law. Although no one such provision can be said to overburden the tax system, in total they do. When, for example, a tax credit is enacted to encourage or reward those who insulate their homes, which may benefit a few million taxpayers, the tax forms and instructions are complicated for all 100 million taxpayers. The overall effect of these provisions is to render the tax system unintelligible for far too many of the taxpayers required to cope with it. I believe voluntary compliance is seriously diminished when taxpayers see the tax system as a confusing mystery rather than as a fair means of allocating the costs of government.

Incentives supplied through the tax system too often are attractive to lawmakers because they are seen as efficient, simple and costless. They are said to be efficient and simple compared to similar direct expenditure programs because the tax incentives seem relatively free of red tape. But red tape is only a name applied to controls. It is true, for example, that tax incentives for real estate are largely free of the red tape associated with real estate incentive programs administered by the Department of Housing and Urban Development. This is not, however, because there is any inherent difference between direct expenditure or loan programs and tax incentives. Rather the red tape associated with HUD projects and the lack of it in tax incentives is the result of our lawmakers' apparent unwillingness to have funds disbursed directly without rigid standards. Yet, for some reason they seem satisfied to have revenues lost through tax benefits with very loose standards and little control. The absence of red tape, in other words, results not from the decision to use the tax system but rather from a decision to dispense with most standards and controls.

> Tax expenditures are, of course, not costless. For example, a tax credit given to one who insulates his home affects both the government and the recipient in exactly the same way as a grant of the same amount paid for the same purpose. And yet the tax provision does not go through the congressional appropriation procedure and does not appear as an item in the budget. It is only noted in an appendix. While considerable strides have been made in recent years in accounting for tax expenditures through the budget process, there are many who still think of tax incentives as different from direct expenditures.
>
> In the interests of long-range simplification and administrability of the tax system, the Internal Revenue Service should place a high priority on resisting attempts to use the tax system to achieve nontax goals.

Not only do tax expenditures create most of the complexity in our tax system, but because they significantly narrow the tax base -- the amount subject to tax -- they require high marginal rates on the income that remains subject to tax.

The complexity and high rates associated with tax expenditures are undoubtedly major contributors to the compliance problems troubling our tax system. Moveover, because of tax expenditure provisions -- deviations from a comprehensive definition of income as a measurement of financial well being and ability to pay tax -- many high income taxpayers, individuals and corporations, pay little tax. This situation is well perceived by most taxpayers who feel, frequently with substantial justification, that they are mistreated by our tax laws. Again, compliance suffers.

At least as important as the obstacles to the efficient functioning of our tax collection system which tax expenditures create are the problems their use presents on the spending side of the budget. Stated simply, because we finance programs and projects both by direct spending and through tax relief provisions, there is no rational system for setting and carrying out national priorities. And this is a problem of increasing magnitude.

In 1967 the tax expenditure budget contained 50 items with a revenue loss of $36.6 billion. This represented 20.5% of total direct federal spending. By 1981 tax expenditures had risen to 34.6% of direct spending and their number had doubled. The total revenue loss from tax expenditures as estimated by the Joint Tax Committee for 1982 will be $253 billion and will rise to $439 billion in 1987.

While direct spending is being reviewed under a microscope in an attempt to narrow our huge projected deficits, over $250 billion of spending through the tax system has been largely ignored. Government programs to provide low income housing are being cut to the bone or eliminated. At the same time the tax system is providing over $45 billion in subsidies for home ownership -- including tax expenditures to subsidize second and third homes.

Is it logical to scrutinize the medicaid program and ignore the deductibility of medical expenses allowed to the more affluent? We need a budgetary process that requires all government programs to be considered together; that requires program priority be set for the entire budget -- both direct spending and tax spending.

I'm not suggesting that the answer in such consideration will always be to eliminate the tax expenditure, but only that the budget process consider the entire budget -- not just three-quarters of it.

The Committees that consider the direct programs in particular areas ought to consider the tax expenditures in that area. The Executive Departments and agencies with direct program responsibilities should be charged with their tax expenditures. If this could be done effectively, I am convinced that the rationality of our overall system of governmental assistance would improve vastly, as would our tax system.

I do not feel in a position to recommend a particular Congressional procedure to accomplish this coordination, but I would strongly recommend that such coordination be implemented within the executive branch. Executive departments, in compiling their budget requests, should be charged with tax expenditures in their areas of responsibility.

In their program recommendations, they should have the ability to recommend substitution of direct programs for tax expenditures or the reverse. But they should not be in the position, as they are now, to favor tax incentives over direct programs because the former are not charged to their budget.

For example, the Department of Housing and Urban Development is projected to have budget outlays for fiscal year 1982 of $14.6 billion and in 1983 of $13.1 billion, according to the Administration's 1983 budget. Tax expenditures connected with housing total at least $35 billion for 1982 and somewhat more for 1983. It is virtually impossible to believe that if this entire total were charged to HUD it would have made its cuts of $1.5 billion in the same way. Under current procedures it was faced with cutting only its direct budget and not its tax expenditure budget.

You have asked whether there is any need to change the definition of "tax expenditures." I believe that the definition contained in the Budget Reform Act of 1974 is quite clear, particularly when the legislative history of that act is taken into account and when the statutory language is considered against the background of tax expenditure budgets which existed at that time. However, notwithstanding this history and consistent precedent, Special Analysis G to the 1983 budget changes the definition in a way which clearly violates the 1974 Budget Reform Act. One result of this change is that the revenue loss attributable to the Accelerated Cost Recovery System is not reflected as a tax expenditure. The explanation for this change contained in Special Analysis G is entirely unconvincing and leaves the whole issue of the definition of tax expenditures in a muddle. Tax expenditures are a tool for analysis and do not in themselves represent a policy judgment. It is therefore particularly unfortunate that the Administration has chosen to distort the definition of tax expenditure for what apparently is their own political end.

That ACRS is a tax expenditure is unquestionable. It provides for recovery of costs by a method which bears no relationship to either economic depreciation or depreciation as measured by accountants. Moreover, within the ACRS provisions themselves the extraordinary nature of the deduction is recognized by providing for more conservative cost recovery allowances in computing earnings and profits for purposes of determining the taxation of dividend distributions.

Finally, you have asked me to comment on various tax proposals that have been put forward by the Administration and others.

While I have not studied the Administration's proposals in detail, I believe they are aimed at particular problems which are worthy of attention.

The completed contract method of accounting is responsible for significant revenue losses with little justification.

The business energy tax incentives were a mistake from the beginning and warrant repeal.

The entire industrial development bond area is worthy of serious reconsideration. The effect of this type of financing has been to distort seriously the exempt bond market, raising the cost to state and local governmental units of financing their essential governmental activities, and to provide benefits in a haphazard and inefficient way. The cutbacks proposed represent a minimum which should be done. In my view, substantial arguments can be made for eliminating this kind of financing completely.

The use of modified co-insurance to reduce the tax burden of insurance companies seems unwarranted. The overall question of the method of taxation of insurance companies, however, is one which should be dealt with in some detail.

The corporate minimum tax proposal is one which raises the basic question of using a minimum tax to attack, in a half-hearted way, unwarranted tax expenditures. It would obviously be preferable to address each of these items of tax preference individually and where the tax subsidy is found to be too generous to cut back or eliminate the subsidy itself. Creating an alternative tax system results in enormous complexity, difficulty in planning and inconsistent tax treatment of corporations depending on the range of their activities. While it moves in the right direction, it does not get at the heart of the problems which it addresses.

There have been numerous suggestions to reduce or defer individual tax cuts legislated by the Economic Recovery Tax Act last year. Curiously, I have not seen any proposal which would address the Accelerated Cost Recovery System enacted at the same time although there have been numerous proposals to reduce or eliminate the safe harbor lease provisions of that act.

The individual tax reductions which were legislated represented, for the most part, reductions necessary to mitigate the effects of inflation on our progressive tax system. Even with these cuts, the overall effect of tax rates through 1984 will remain essentially unchanged from what they were in 1980. Unfortunately, the lowest income taxpayers will still have tax increases during that period with reductions going to the highest income taxpayers. This comes about because of the legislated increases in social security taxes, the fact that no increases were legislated in exemption levels and the disproportionately large decrease in the maximum rate.[2] This distortion in relative tax burdens is exacerbated by the fact that spending cuts will have a profound impact on lower income households. For example, the legislated decreases in cash and in kind benefits for 1984 will be $18 billion, almost half of which will come from households with under $10,000 income.[3] Deferring the individual cuts will only make these problems worse.

While there have been numerous suggestions to modify or repeal safe harbor leasing provisions of the Economic Recovery Tax Act, little attention has been paid to ACRS itself. While the leasing provisions present their own set of problems by compounding and exaggerating the difficulties of coordinating tax expenditures with direct expenditures, they are a symptom of the basic problem rather than the problem itself.

If the ACRS benefits were not as rich as they are, the pressure to create a transfer mechanism would diminish. But the benefits are indeed rich and will result in tax losses for large numbers of corporations.

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[2] See *The Effects of Inflation and Social Security Tax Increases on the Tax Liabilities of Typical Taxpayers in 1980 Through 1984*, Congressional Research Service, Library of Congress, February 3, 1982.

[3] See *Effects of Tax and Benefit Reductions Enacted in 1981 for Households in Different Income Categories*, Special Study Prepared by Staffs of the Human Resources and Community Development Division of the Tax Analysis Division, Congressional Budget Office, February, 1982.

The current economic report of the President contains a table which shows the before-tax rate of return on new investment required to produce an after-tax rate of return of 4%. For general industrial equipment for the years 1975 to 1979 the pre-tax rate of return required was 6.4%. For 1985 it will be 2.7%. That means that the tax benefits under ACRS will not only eliminate the tax on new investment but will supplement the rate of return, increasing it from 2.7% to 4%. These rates of return take into account projected inflation. When we create a cost recovery system which provides negative tax payments company to company distortions become severe. In my view leasing should be re-examined in the context of a re-examination of ACRS.

I would look first to the corporate tax reductions to provide the revenue necessary to lessen our budget deficits and to restore some semblance of equity to our tax system.

Chairman **Domenici**. I have to leave rather soon to attend a meeting with Majority Leader Baker. Senator Boschwitz will preside then.

I think we will proceed without asking questions other than one to lay the groundwork for Dr. Walker's testimony. I am not sure that I will be here when he testifies, but I would like to have the panel comment on the public perception of unfairness and complexity in our tax system and its implications for the country.

TAXPAYERS' ATTITUDES TOWARD THE TAX SYSTEM

Our President quite properly says we should not balance the budget on the backs of the taxpayers.

I wonder whether the people responding in surveys saying that they agree include the $100 million tax refund of General Electric as balancing on their backs. I do not think they do. I think they are addressing the marginal tax rates and unlegislated tax increases from inflation.

The more tax expenditures increase, the less opportunity there is to reduce marginal tax rates.

It does not appear to me that the American taxpayers, responding as they are in surveys, believe that this kind of refund should continue. I think they perceive this as one of those ingredients of our Tax Code that connotes inequity and fairness.

Would you care to comment based on your experience?

Mr. **Kurtz**. When I was with the Internal Revenue Service, we tried many ways to determine taxpayers' attitudes toward the tax system through various surveys, none of which, I might say, was very successful. But there are certain general attitudes that do emerge, and that is that middle-income taxpayers believe that they are overtaxed, not so much in an absolute sense but rather in a comparative sense. Taxpayers read the newspapers, they read about tax shelters that are not available to them, and they will read this article, and there is a sense that the tax system is overburdening middle and lower income taxpayers and not sufficiently taxing higher income taxpayers.

I might say that perception is an exaggeration of reality, but it is not wholly without a basis in reality. I think that is an important point in the reality of tax administration.

Chairman **Domenici**. Mr. Walker, I am going to depart soon and I want to ask you a question.

RAISING DISCERNIBLE NEW TAXES

If Congress decided that they wanted to move more dramatically toward a balanced budget, having done all they could in budget cuts, perhaps even more than the President recommends over the next 3 years, and they concluded that we needed to raise new taxes, of say $30, $40, $50 billion, respectively, over the next 3 years, how would you raise it?

First, would you change in any way the personal tax cuts that are in place and not yet effective? Would you change any of the tax expenditures, or would you do it another way?

Dr. **Walker**. Mr. Chairman, before I respond, let me apologize for my late arrival. I am glad to be here today.

Chairman **Domenici**. That is all right.

Dr. **Walker**. In responding to your questions, I am speaking for myself, not as chairman of the American Council for Capital Formation. The ACCF is split on those questions just as many other business organizations are.

However, I am very much on the record in testimony before the House Ways and Means Committee, on February 19, 1982, with respect to my personal recommendations. One issue seems very important to me. We must do something about the budget deficits forecast over the next few years. We must act quickly, too, in a way that will result in market forces bringing down interest rates, or the economic recovery is going to be unduly delayed and unduly weak. In dealing with the spending side of the issue, my recommendation was that Congress hold the total of on-and off-budget spending in fiscal 1983 to the $773 billion requested by the President, on 22.5 of GNP.

For his part I recommended that the President consider revenue measures that would significantly reduce deficits in fiscal year 1983 and beyond. I feel strongly that these measures should generate big chunks of revenues. I do not think that you can take a list of tax expenditure items from the CBO or wherever and expect Congress to act on them expeditiously. The politics of raising revenue this way are very difficult, as you know.

RECOMMENDATIONS FOR RAISING REVENUE

I selected three big chunks which would go a long way toward raising revenue in the amounts you mentioned. My first recommendation was for immediate deregulation of newly discovered gas, and phaseout of controls on all other gas over 3 to 5 years. I would levy a 75-cent per Mcf severance tax on all gas, across the board. The tax could be made effective as of January 1, 1983, and expire the end of the decontrol period. That would raise in the neighborhood of $10 to $15 billion a year.

I recommended an oil import fee of $5 per barrel, again for a 3- to 5-year period. That, according to CBO, would raise some $17.5 billion per year. That brings total revenue raised to about $30 billion. I believe these two items are fully justified on the basis of energy policy, not just as revenue-raising measures.

I also said that if additional revenue is needed, consideration should be given to delay, not suspension, just delay, of the 1983 individual tax cuts. In my oral testimony before the Ways and Means Committee, I went into some detail about the role that I played in the development of the Reagan economic policy. That policy had as its centerpiece a 5-year economic game plan to bring Federal spending down below 20 percent of GNP. Along with spending reductions, the game plan envisioned across-the-board reductions in individual tax rates and indexing of the tax brackets after the rate reductions were phased in. An adjustment in the President's economic game plan that delayed the 1983 tax cut for a year until, say, 1984 would accomplish the President's goal within the 5-year period. This is consistent with the original game plan, and is not a jettisoning of Reaganomics.

Chairman **Domenici**. Well, Dr. Walker, obviously the deregulation is out.

Dr. **Walker**. I am sorry to hear that, sir.

Chairman **Domenici**. It might have been out even if it was tried. But it is not going to be tried.

The oil import fee has attracted some interest during the glut. It might not even cause signficant price increase to the consumers of the country. It might be absorbed to some extent by the oil cartel. So that leaves an oil import fee plus a deferral of the individual tax cut. Is that correct?

Dr. **Walker**. Yes.

Chairman **Domenici**. One question of you, Dr. Walker, and then I am going to turn it over to Senator Boschwitz.

CAP SHOULD BE CONSIDERED ON ALLOWABLE REDUCTION IN TAX LIABILITIES

You were a strong proponent of the safe harbor leasing provisions. Did you expect a company like General Electric to get a refund like the one reported in today's papers of $100 million?

Dr. **Walker**. I do not know if I expected any one given company to deal in magnitudes of that order, but I would like to comment on the news article concerning the General Electric situation.

Let me say, first of all, that the public perception that big companies do not pay taxes is very prevalent.

I see no reason whatsoever why there should not be some kind of cap or limit on the degree to which the current tax liability of a buying company can be reduced under the safe harbor rules. But, as a matter of fact, the cases that make news are not backed up by what is going on in the universe of safe harbor leasing transactions.

Just off of the press last night is a study by Arthur Andersen and Company of over $4 billion (both buyer and seller) of safe harbor transactions in 1981. The study shows that the tax liabilities of companies surveyed were reduced by only about 40 percent, a far smaller reduction than in the more famous cases.

The point I want to make is that, yes, a cap on limitation on the allowable reduction in tax liabilities should be considered, but what upsets me about that particular news article and others like it is that there is another side to this coin. For example, when IBM purchased $150 million of tax credits and deductions from Ford Motor Co., where did the money go? I went to Michigan to one of our distressed industries and distressed companies. Ford had $1 billion worth of losses last year, had to pass its dividend and negotiate a give-back contract with its labor union. The leasing money is going to distressed industries, precisely where is should. If there are abuses with respect to safe harbor leasing they certainly ought to be corrected. Because the provisions were passed by Congress last year without adequate discussion, they should be explored now. In fact, the Senate Finance Committee is taking up that discussion tomorrow morning.

DISTRESSED INDUSTRIES HELPED BY SAFE HARBOR LEASING

We have to realize that we are in a recession. This is the first recession we have had in my memory where fiscal policy was properly on board when the recession began. The tax cuts were in place. The business tax cuts, were effective January 1, 1981, and the first stage of the individual cuts went into effect in October 1981. More importantly, safe harbor leasing is putting the business tax cuts directly into six or seven distressed industries where the unemployment is highest, where the investment needs are enormous just to keep up with foreign competition.

What would happen if we repeal safe harbor leasing? The Arthur Andersen survey shows if Congress repeals safe harbor leasing, and especially if it is retroactive to February 19, you would be raising taxes in a recession on the weakest industries in the United States. That is the problem that is facing Congress.

I think there are ways to work it out, but there are a lot of other sides to the story that was in the paper yesterday.

Chairman **Domenici**. Dr. Walker, I just want to leave this thought before I leave. I had the privilege of spending an hour and a half with Arthur Burns this morning. I really have the greatest respect for him. And it appears to me that the analysis that you have just made is going to become irrelevant if we do not get interest rates down. We could continue to call American businessmen into rooms and tell them to get going—and I note you are shaking your head—I believe that would not work because they have nothing to get going with with interest rates high and the demand down. Small businessmen are selling out, if they are lucky. The others are not even able to invest or get out.

REDUCTION NEEDED IN SIZE OF PROJECTED DEFICITS

So, it appears to me that you have to ask how you get the deficit down. I would ask you if you agree that we have to have a credible and dramatic reduction in the size of the projected deficits for the years 1983, 1984, and 1985. Do you agree with that?

Dr. **Walker**. Yes, sir, and I think you would recall when you and I discussed that 5-year game plan, the goal was to have a balanced budget by 1985 or 1986. I favor return to that timetable.

Chairman **Domenici**. Now, if that is the case, and we do all we can in budget reductions, then would you agree that we have to raise the rest in revenue; would you not?

Dr. **Walker**. Yes.

Chairman **Domenici**. Mr. Sunley, did you want to answer any of my questions?

Mr. **Sunley**. Just to respond very briefly.

I agree with Dr. Walker that the deficits are clearly a problem. When you look at the current services budget and see the rising deficits as a percentage of GNP as the economy recovers from this recession, you need to be concerned.

I believe also that after you have looked at all the direct spending programs, you should also carefully examine all the indirect spending programs through various tax expenditures as possible ways of reducing the size of the deficits. We do allocate Government resources through the tax system, and these indirect spending programs should be subject to the same kinds of careful examination as the direct spending programs, to make certain that they meet important national needs and are efficient at doing so.

Chairman **Domenici**. Is medicare an example of what you are talking about? We are constantly told about the dramatic increase in the percent of GNP going to medical care programs. My recollection is that this percentage is going up to 10 or 11 percent. This is an incredible increase compared to 15 years ago when we did not even have medicare or medicaid.

Are you suggesting that if we are worried about the inflationary impact of those programs on medical costs, that we should also look at the Tax Code?

Is that what you mean that there is a correlation between the expenditure side and the revenue side?

Mr. **Kurtz**. Yes; exactly. We ought to look at it as what the Federal Government policy is in dealing with medical costs, and we have several different policies. We have medicare and medicaid. We have the deductibility of medical expenses and the exclusion of income if the employer pays medical plans. I am not sure how that examination would come out, but one ought to look at the whole package and decide, if cuts have to be made, if controls have to be exerted, what the priorities are—which programs ought to take the cuts?

Chairman **Domenici**. That is what you have in mind?

Mr. **Sunley**. I would agree, too, Mr. Chairman.

I think there is some evidence that the tax law encourages very generous employer provided medical care plans, first dollar's coverage, low coinsurance rate, and this may contribute to excessive demands on the health system.

Chairman **Domenici**. I want to correct the record. That statement of 10 to 11 percent of GNP on medical is all total medical costs, not just those programs.

Dr. **Walker**. Mr. Chairman, I would like to make one point concerning what Dr. Sunley has said.

LOOK FOR THE BIG ITEMS

I have no objection to examining tax preference items. I am simply suggesting you look through the tax expenditure list and note where the really big items are, where there might be some savings. The big tax expenditures include deductibility of mortgage interest on owner-occupied homes, which amount to $26 billion in fiscal 1983, capital gains, $22 billion in fiscal year 1983, the investment credit, $27 billion in fiscal year 1983, and deductibility of charitable contributions, $8.1 billion in fiscal year 1983.

Senator **Boschwitz** [presiding]. Where are you reading from?

Dr. **Walker**. I am reading from Special Analysis G of the Budget for Fiscal Year 1983 which is published by the Office of Management and Budget. This document lists tax expenditure items.

Senator **Boschwitz**. Are you suggesting that we not allow mortgage interests to be deducted?

Dr. **Walker**. Quite the contrary. I am saying that if you are looking at tax expenditures to balance the budget or reduce the deficits, you are not going to get very far. Examining all tax expenditure items with the idea of raising significant revenues is not going to be a fruitful approach in the period of time involved because of the economic importance of many of the items. You are not going to reduce the investment tax credit, for example, or many other things. It would take 10 years to go through these items and you still would not get much money out of it.

Senator BOSCHWITZ. So, you would take a more macro approach and fund more——

Dr. WALKER. I would look to raising big chunks of revenue.

Senator BOSCHWITZ. Big chunks?

Dr. WALKER. Big chunks.

Senator BOSCHWITZ. I think we have to do both.

I am not quite sure at what point we are in the hearing. Mr. Kurtz, you have testified?

Mr. KURTZ. Yes; I have.

Senator BOSCHWITZ. And, Mr. Walker kind of testified in response to the chairman's questions.

I believe you have a formal statement.

Dr. WALKER. Yes; I do. I am at your disposal, Mr. Chairman.

Senator BOSCHWITZ. Do you want to go ahead in that case?

Dr. WALKER. I have about a 7- or 8-minute statement.

Senator BOSCHWITZ. Please go ahead in that case.

Dr. WALKER. I am going to excerpt parts of the statement that I submitted.

Senator BOSCHWITZ. Incidentally, the natural gas deregulation is a nice idea. If oil comes down far enough in price, it might do it. We will see what happens.

STATEMENT OF CHARLS E. WALKER, CHAIRMAN, AMERICAN COUNCIL FOR CAPITAL FORMATION

Dr. WALKER. Mr. Chairman, this committee is to be strongly commended for its historic bipartisan role last year in reducing the growth in Federal spending and its current focus on deficit reduction in fiscal year 1983 and beyond. One approach to deficit reduction would be to submit tax expenditures to the budget process. In the judgment of the American Council for Capital Formation that would be bad budget policy, bad tax policy, and bad public policy because of fundamental definitional and measurement problems inherent in the tax expenditure concept.

DEFINITION OF TAX EXPENDITURE SUBJECT TO ARBITRARY MANIPULATION

The definition of direct Federal spending is of longstanding, simple, unambiguous, and widely understood—all important virtues for a fiscal limitation that requires the understanding and support of a majority of voters. The tax expenditure concept is just the reverse—it is relatively new, complex, fuzzy, and the subject of how much debate among fiscal experts. The definition is subject to arbitrary manipulation. In addition, the major beneficiaries of tax expenditures are not, as is widely reported and believed, rich people and business corporations, but the typical hard-pressed middle and lower income taxpayer.

When tax expenditures are placed under an analytical microscope, one must conclude that it is highly regrettable that so imprecise and misleading a concept became embedded in law in the first place. Today we object to the attempt to give this concept added credence by going one step further and incorporating it as a tool in the congressional budget process in an effort to control record level deficits.

Major problems arise from the concept of a "normal structure" of the individual and corporate income taxes. What is "normal" and who has so decided? Take the example of the corporate tax, now 46 percent. The corporation does not pay it. The corporate tax is simply a legal arrangement for doing business. The tax is either passed forward to consumers or backward to labor and capital. So, we have a problem to begin with, and to say that the 46-percent rate is normal when you do not know who pays the tax seems abnormal to me.

I suspect that the matter of definition has by default been delegated to middle-level officials, whose past decisions have shown a bias toward making tax expenditures loom larger and larger, suggesting that they work primarily to the benefit of rich people and big business.

The fact is that the major beneficiaries of these tax preferences are neither rich individuals nor large corporations. Seventy-eight percent of the dollar total of tax expenditures in fiscal year 1982 go to individuals, primarily in the middle and lower income ranges. The largest results from nontaxation of employer contributions to workers' pension and medical plans. Another large tax expenditure is the longstanding deduction for interest and property taxes on homes. The nontaxability of social security benefits is a tax expenditure. And so on.

CAPITAL GAINS ILLUSTRATE OTHER DEFINITIONAL PROBLEMS

The tax expenditure treatment of capital gains illustrates other definitional problems. Classical economists do not consider capital gains to be income, stressing instead the eminently sensible idea that income should be viewed in terms of consumption with savings excluded. That other countries implicitly accept this view is indicated by the fact that most of them do not tax capital gains at all, or only lightly. In this country those officials who define tax expenditures have decided that tax rates on capital gains deviate from the norm. And, therefore, the 1983 special analysis G of the budget, which defines tax expenditures, lists $18 billion of revenue loss from that source for fiscal year 1982. The absurdity of that conclusion is obvious; both logic and experience convincingly indicate that a sharp increase in tax rates on capital gains would lock up appreciated assets, dry up selling, and actually reduce the Federal tax take from that source. That is what happened in 1969 when we raised capital gains taxes.

Until 1977, the fact that this country did not tax capital gains at death went unnoticed by the definers of tax expenditures. I should not say it went unnoticed, but they did not assume it was a tax expenditure. But in the budget documents of that year, the tax expenditures estimate for capital gains more than doubled. And it puzzled me why it could double overnight.

Examination of the fine print in the budget showed the officials in charge of defining tax expenditures had, with no public notice or discussion, redefined capital gains tax expenditures to include taxes foregone on property transferred at death. This demonstrates how definitions and totals can be manipulated without, so far as I can determine, consultation with Congress.

DIRECT SPENDING AND TAX EXPENDITURES CONTRADICTORY

A more basic objection to including tax expenditures in any spendinq limit stems from the fact that the combination of the two concepts is inherently contradictory. There is a vast difference between an expenditure and failing to tax as heavily as might be possible. The money raised by taxes—or foregone through tax expenditures—is the taxpayer's money to beqin with; to permit it to remain with the taxpayer is not a grant to which the Government was entitled at the outset.

In a broader sense, the contradiction between direct spending and tax expenditures is even more apparent. The effort in limiting direct spending is to restrict the amount of national output that the Government can command; the size of the Federal establishment is thereby contained. A limitation on tax expenditures would have precisely the opposite effect. Such a limitation would, in fact, tend to institutionalize a certain minimum size for the public sector at the expense of the private sector.

To cite the clearly imposing set of problems that surround the tax expenditure concept is not to say that Members of Congress should be unconcerned about past and, perhaps, future proliferation of tax preferences. Heavy reliance on tax preferences to promote social and economic goals is an inevitable concomitant of a system of heavy income taxes in a participatory democracy. The task before Congress, it seems to me, is to avoid the pitfalls inherent in reliance on the oversold tax expenditure concept; and, especially, not to enshrine it in the congressional process as a mechanism to control excessive budget deficits. A more appropriate approach would be to continue the frequent review of the preferences in the tax writing committees—an impressive compilation of House Ways and Means Committee reviews for the period 1974–81 is included in the appendix to my statement—and to proceed carefully to reevaluate this rather strange concept that found its way into the law in 1974.

Thank you, sir.

Senator **Boschwitz**. Thank you.

PREPARED STATEMENT OF CHARLS E. WALKER, CHAIRMAN, AMERICAN COUNCIL FOR CAPITAL FORMATION

Mr. Chairman and Members of the Committee, my name is Charls E. Walker. I am volunteer Chairman of the American Council for Capital Formation. I appreciate the opportunity to present the views of the American Council on the tax expenditure concept and, specifically, the bills introduced by Senators Kassebaum and Hart, S. 193 and S. 2069, to amend the Congressional Budget Act to include tax expenditures in the aggregate targets or limitations in budget resolutions.

The American Council for Capital Formation is an association of individuals, businesses, and associations united in their support of legislation to eliminate the tax bias against saving and productive investment. Our members, individuals as well as business, support legislative measures which are designed to encourage the productive capital formation needed to sustain economic growth, reduce inflation, restore productivity gains, and create jobs for an expanding American work force.

I commend this Committee for its historic bipartisan role last year in reducing the growth in Federal spending and its current focus on deficit reduction in FY 1983 and beyond. One approach to deficit reduction would be to submit tax expenditures to the budget process. In our judgment that would be bad budget policy, bad tax policy, and bad public policy because of fundamental definitional and measurement problems inherent in the tax expenditure concept.

A Limitation on "Tax Expenditures?"

What is wrong with the idea of new legislation to control tax expenditures? In my oral testimony I shall address a few major problems associated with this significant departure from current budget and tax policy making. However, I am also submitting an appendix to my testimony which discusses in greater detail several other complex and technical objections to the concept of tax expenditures, itself, and its interaction with the budget process.

The definition of direct Federal spending is of long standing, simple, unambiguous, and widely understood--all important virtues for a fiscal limitation that requires the understanding and support of a majority of voters. The "tax expenditure" concept is just the reverse--it is relatively new, complex, fuzzy and the subject of much debate among fiscal experts. The definition is subject to arbitrary manipulation. In addition, the major "beneficiaries" of "tax expenditures" are not, as is widely reported and believed, rich people and business corporations, but the typical hard-pressed middle- and lower-income taxpayer.

When "tax expenditures" are placed under an analytical microscope, one must conclude that it is highly regrettable that so imprecise and misleading a concept became imbedded in law in the first place. Today we object to the attempt to give this concept added credence by going one step further and incorporating it as a tool in the Congressional budget process in an effort to control record level deficits.

The tax expenditure concept was first introduced in legislation in the Congressional Budget Act of 1974. The Act defines "tax expenditures" as "revenue losses attributable to the provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." The legislative history of the Budget Act attempts to pin down the definition for operational purposes by referring to exceptions to the "normal structure" of the individual and corporate income taxes. "Tax expenditures" are, in short, what we used to refer to by the less pejorative term, "tax preferences," with none of the perversion of the English language that is inherent in linking the words "tax" and "expenditure."

Do Members of Congress use the term "tax expenditures" in talking with their constituents? Do those constituents believe that the income tax deductions and credits they receive for mortgage interest, property taxes, charitable giving, medical expenses and business investment in new equipment are essentially the same as Federal spending on defense, education or welfare? I would be very surprised if they did.

Major problems arise from the concept of a "normal structure of the individual and corporate income taxes." What is "normal" and who has so decided? I suspect that the matter of definition has by default been delegated to middle-level officials, whose past decisions have shown a bias toward making "tax expenditures" loom larger and larger, suggesting that they work primarily to the benefit of rich people and big business.

As an example of their bias, consider their failure to include the personal exemption and the zero bracket deduction (formerly called the standard deduction) in the tax expenditure list. Both the personal exemption and the zero bracket amount provide the same type of benefit for lower- and middle-income groups as do itemized deductions for higher income taxpayers.

The fact is that the major beneficiaries of these tax preferences are neither rich individuals nor large corporations. Seventy-eight percent of the dollar total of "tax expenditures" in FY 1982 go to individuals, primarily in the middle- and lower-income ranges. The largest results from non-taxation of employer contributions to workers' pension and medical plans. Another large "tax expenditure" is the long-standing deduction for interest and property taxes on homes. The nontaxability of social security benefits is a "tax expenditure." And so on.

The "tax expenditure" treatment of capital gains illustrates other definitional problems. Classical economists do not consider capital gains to be income, stressing instead the eminently sensible idea that income should be viewed in terms of consumption with savings excluded. That other countries implicitly accept this view is indicated by the fact that most of them do not tax capital gains at all, or only lightly. In this country those officials who define "tax expenditures" have decided that tax rates on capital gains deviate from the norm. And, therefore, the 1983 Special Analysis G of the budget, which defines tax expenditures, lists $18 billion of revenue loss from that source for FY 1982. The absurdity of that conclusion is obvious; both logic and experience convincingly indicate that a sharp increase in tax rates on capital gains would "lock up" appreciated assets, dry up selling, and actually reduce the Federal tax take from that source. In fact, when tax rates were cut on capital gains in 1978, Treasury receipts went up dramatically in 1979 by $1.8 billion for individuals rather than falling off as officials had forecast.

Until 1977, the fact that this country did not tax capital gains at death went unnoticed by the definers of "tax expenditures." But in the Budget Documents of that year, the "tax expenditures" estimate for capital gains more than doubled. Examination of the fine print in the Budget showed the officials in charge of defining "tax expenditures" had, with no public notice or discussion, redefined capital gains "tax expenditures" to include taxes foregone on property transferred at death. This demonstrates how definitions and totals can be manipulated without, so far as I can determine, consultation with Congress.

A more basic objection to including "tax expenditures" in any spending limit stems from the fact that the combination of the two concepts is inherently contradictory. There is a vast difference between an expenditure and failing to tax as heavily as might be possible. The money raised by taxes--or foregone through "tax expenditures"--is the taxpayer's money to begin with; to permit it to remain with the taxpayer is not a grant to which the Government was entitled at the outset.

In a broader sense, the contradiction between direct spending and "tax expenditures" is even more apparent. The effort in limiting direct spending is to restrict the amount of national output that the Government can command; the size of the Federal establishment is thereby contained. A limitation on "tax expenditures" would have precisely the opposite effect. Such a limitation would, in fact, tend to institutionalize a certain minimum size for the public sector at the expense of the private sector.

To cite the clearly imposing set of problems that surround the "tax expenditure" concept is not to say that Members of Congress should be unconcerned about past and, perhaps, future proliferation of tax preferences. Heavy reliance on tax preferences to promote social and economic goals is an inevitable concomitant of a system of heavy income taxes in a participatory democracy. The task before Congress, it seems to me, is to avoid the pitfalls inherent in reliance on the oversold "tax expenditure" concept; and, especially, not to enshrine it in the Congressional process as a mechanism to control excessive budget deficits. A more appropriate approach would be to continue the frequent review of the preferences in the tax-writing committees (an impressive compilation of House Ways and Means Committee reviews for the period 1974-1981 is included in the appendix), and to proceed carefully to re-evaluate this rather strange concept that found its way into the law in 1974.

PROBLEMS WITH THE TAX EXPENDITURE LIMITATION PROPOSALS

As the foregoing remarks have indicated, the concept of tax expenditures is inherently flawed. It goes without saying, however, that special provisions of the tax law providing deductions, tax exemptions, and credits should be constantly re-examined to determine if they are effectively fulfilling the function intended by Congress. However, placing limits on tax expenditures in budget resolutions, as the two bills under consideration by this Committee would do, is not an effective approach to gaining control over unwarranted loopholes in our tax system or to controlling burgeoning Federal deficits.

S. 193

S. 193 would amend the Congressional Budget Act of 1974 to establish a ceiling on revenue losses from tax expenditures and to require new budget authority for new tax expenditures. The Budget Act requires, in Section 301, that the first concurrent resolution on the budget set forth the recommended level of Federal revenues and the amount, if any, by which the aggregate level of federal revenues should be increased or decreased by bills and resolutions. S. 193 would add the provision that it shall not be in order for either House to adopt a first concurrent resolution on the budget for any fiscal year if the level of revenue loss from tax expenditures contained in the resolution exceeds 30 percent of the recommended level for net revenues set forth in such resolution.

This bill would be bad policy for several reasons. First, tax expenditures are impossible to measure accurately. The total cost of tax expenditures cannot be found by simply adding up the "cost" of each separate provision. For example, if we eliminate one provision, such as the deduction for home mortgage interest, some taxpayers would switch from itemizing deductions to using the zero bracket amount. This switch would also eliminate several other deductions which the homeowner may have been claiming and which were classified as "tax expenditures." In addition, cutting out some categories of tax expenditures might simply cause taxpayers to switch to others. For example, homeowners denied the mortgage interest deduction might purchase more tax-exempt municipal bonds, thereby increasing that category of tax expenditure. Therefore, eliminating one "tax expenditure" could decrease the total for all of them or increase total tax receipts by an amount which differs from the estimated cost of that one provision.

Second, quite aside from the practical measurement and definitional problems inherent in the concept of tax expenditures, S. 193 would further impede the already imperiled budget process by setting an arbitrary limit on the revenue loss from tax expenditures contained in the first budget resolution. Regardless of the limit set, any calculated total of tax expenditures would vary as a percent of total revenue due to the variations in the underlying estimates of the expenditures themselves and tax revenues. Fluctuations in economic activity, which have such a substantial impact on budget totals, would also affect on the total of tax expenditures. Under S. 193, if the ceiling were breached, for example because of an economic downturn, it could be necessary to attempt to increase taxes or reduce tax expenditures. Such action could not help but exacerbate a cyclical downturn. S. 193 would also subject a similar limit on the second, or any succeeding, budget resolutions.

S. 2069

S. 2069 would make "tax expenditures" subject to the same budget restrictions as tax receipts. The bill would require that budget resolutions set "the recommended level of tax expenditures" and "the total amount by which revenues or tax expenditures (or both) are to be changed. The change would start in fiscal 1983. This bill also presents several problems.

First, S. 2069 has some of the same flaws as S. 193, namely definition and measurement problems with tax expenditures.

Second, S. 2069 is unnecessary because tax expenditures are already adequately controlled within the aggregate revenue total of the budget. Enforcing a revenue floor under the second budget resolution under Section 311 of the Budget Act provides the same control over revenue reductions, whether through tax expenditures or increases in general tax reductions, that it does over actual budget outlays. Since the second budget resolution sets a floor on revenues, additional tax expenditures can only be enacted if existing ones are repealed or if other changes are made in the "normal" tax structure.

Third, a requirement that Congress limit, and possibly reduce, the total of tax expenditures each year, would add substantial uncertainty to business and financial planning by taxpayers. This would discourage capital formation and work at cross purposes with the Economic Recovery Tax Act of 1981 which sought to improve taxpayer certainty by specifying tax changes several years ahead.

CONCLUSION

On behalf of the American Council, I strongly urge that Congress not add to the already complex and difficult process of passing budget resolutions by amending the Budget Act with S. 193 or S. 2069. The concern with the size of projected deficits should not cause us to adopt unworkable and impractical legislation. The very real need to control record-high deficits should be addressed directly through spending cuts. If additional tax revenues must be raised let us continue to make use of the traditional tax legislation process.

APPENDIX A

Considerations Regarding "Tax Expenditures" and its Appropriateness for the Congressional Budget Process

1. The term "tax expenditures" (TEs) is a misnomer which implies that all wealth belongs to the government, with the exception of what citizens are specifically allowed to keep. On the contrary, all wealth belongs to the citizens, recognizing that government can take part of that wealth to run its activities. While there is general acceptance of the concept that the public should fund the government's reasonable and necessary activities through the payment of taxes, it is difficult to argue that many well-accepted tax deductions of long standing, such as mortgage interest expenses and charitable contributions, are, in fact, subsidies by the government.

2. It is impossible to calculate the cost of many "TEs" accurately, because the reduction in tax liability for the recipients may not be known. For instance, tax brackets of recipients of municipal bond interest is not known, since this form of income is not reported on tax returns. Similarly, elimination of certain "TEs" is likely to alter greatly the use of other "TEs." For instance, eliminating the deductibility of mortgage interest would leave many taxpayers unable to afford to purchase homes, thereby cutting the use of the deduction for property taxes.

3. Even when estimates have been made for the cost of all "TEs," it is impossible to calculate an overall

total, because the costs of some are interdependent. Removing one deduction, for instance, will cause some taxpayers to switch from itemizing deductions to the standard deduction (zero bracket amount), thereby reducing the number of additional "TEs" those taxpayers use.

4. Projections of "TEs," far more than many direct spending programs, are sensitive to economic assumptions. For instance, a change in interest rates will directly alter the value of "TEs" for interest paid on home mortgage and consumer loans and interest received on municipal bonds. An interest rate change will also affect the volume of purchases of owner-occupied and rental housing, credit-financed consumer durables, bonds, and stocks. These changes will affect more than a score of other "TEs," including deductibility of property taxes on owner-occupied housing and tax receipts on capital gains.

5. The inclusion of "TEs" in an overall budget limitation percentage would permit an indirect increase in taxes at the very time when there is a pressing need to decrease the tax burden, encourage capital investment and improve real productivity in the United States. A decrease in the aggregate of "TEs" would permit direct spending to escalate. Thus, reduction of "TEs" would not necessarily insure greater fiscal restraint and a slowdown in the growth of the Federal deficit.

6. In terms of absolute dollar amounts, "TEs" have risen dramatically in recent years from $92.9 billion in FY 1975 to $212.0 billion in FY 1981. However, "TEs" as a percentage of GNP in the same time frame have been small, ranging from 6.18 in FY 1975 to 7.25 in FY 1981.

7. The majority of benefits from TEs go to low and middle-income individuals, not to corporations. The 1982 Special Analysis G of the Budget shows that out of a total of $267 billion in TEs in 1982, only 20 percent of "TEs" benefitted corporations; the remaining 80 percent reduced individual income taxes. A review of the "TEs" for individuals reveals that items such as interest on consumer loans, mortgage interest, property tax deductions, and employer contributions for medical insurance make up 50 percent of total for the group. The largest single TE for the corporate sector in 1982 was the Investment Tax Credit; this item was $17 billion or 33 percent of "tax revenue losses" benefitting corporations. Even though the TE list accompanying the FY 1983 budget documents does not show the relative shares of corporations and individuals, a review of the items reveals that individuals still receive the lion's share, including $35 billion for the deductibility of interest on consumer credit and mortgage interest.

APPENDIX B

HOUSE WAYS AND MEANS COMMITTEE REVIEW OF FEDERAL TAX EXPENDITURES
1974-1981
TAX EXPENDITURES ARE FROM THE LIST PUBLISHED JULY 8, 1975 BY THE STAFFS OF
THE TREASURY DEPARTMENT AND THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION 1/

DESCRIPTION	CORP.*	IND.*	Year of Review by House W & M Committee							
			'74	'75	'76	'77	'78	'79	'80	'81
National Defense:										
Exclusion of benefits and allowances to Armed Forces personnel**		x								
Exclusion of military disability pensions		x	x	x						
International Affairs:										
Exclusion of gross-up on dividends of LDC corporations	x			x						
Exclusion of certain income earned abroad by U.S. citizens		x	x	x			x			
Deferral of income of domestic international sales corporations (DISC)	x			x						
Special rate for Western Hemisphere trade corporations	x			x						
Deferral of income of controlled foreign corporations	x	x		x						
Agriculture:										
Expensing of certain capital outlays	x	x		x		x				
Capital gain treatment of certain income	x	x					x			
Natural resources, environment and energy:										
Expensing of exploration and development costs	x	x		x		x				
Excess of percentage over cost depletion	x	x		x						
Capital gain treatment of royalties and iron ore	x						x			
Timber: capital gain treatment of certain income	x	x					x			
Pollution control: 5-year amortization	x			x			x			
Energy credits									x	
Commerce and transportation:										
$25,000 corporate surtax exemption	x						x			
Deferral of tax on shipping companies	x			x	x					
Railroad rolling stock: 5-year amortization	x						x			
Bad debt reserve on financial institutions in excess of actual	x						x			
Deductibility of nonbusiness State gasoline taxes		x	x	x			x			
Community and regional development:										
Housing rehabilitation: 5-year amortization	x	x		x	x		x			
Credit for purchasing new home		x		x						
Education, manpower and social services:										
Child care facilities: 5-year amortization	x					x				
Exclusion of scholarships and fellowships		x		x			x			
Parental personal exemption for student age 19 and over		x					x			
Deductibility of contributions to educational institutions	x	x					x			
Deductibility of child and dependent care expenses		x		x						
Credit for employing public assistance recipients under work incentive (WIN) program	x	x					x			

1/ Updates for 1980-81 by American Council for Capital Formation.

Senator **Boschwitz**. Would you review again, Mr. Walker, the three points that you felt we should consider in balancing the budget from the standpoint of revenue?

Dr. **Walker**. On the revenue side?

Senator **Boschwitz**. Yes.

BALANCING THE BUDGET FROM THE STANDPOINT OF REVENUE

Dr. **Walker**. We must not let up in cutting growth in spending, particularly the entitlement programs. On the revenue side, I suggested speedy and orderly deregulation of natural gas accompanied by an across-the-board severance tax at the wellhead. Revenue raised would depend on the rate of the tax but should be targeted at about $10 to $15 billion a year. A target of $5 a barrel on imported oil, according to CBO, would raise $17.5 billion a year, half from the fee and half from the windfall tax.

Senator **Boschwitz**. A half from the fee and a half from increases in the windfall profits?

Dr. **Walker**. It would automatically increase windfall profits so that it would raise about $10 billion from the fee and $7.5 from the windfall profits portion.

Senator **Boschwitz**. It would have to be on refined products as well as crude?

Dr. **Walker**. Yes. And finally, if necessary, a delay, not a suspension, in the 1983 individual tax cuts of perhaps 1 year. I argued that, in my view, if the Reagan economic program was to achieve its goals of reducing spending, reducing taxes, reducing regulation over a 5-year period, as far as I am concerned, postponing the 1983 cuts 1 year would not jettison the economic program. It would be an appropriate adjustment to bring the spending side and the tax side into balance.

Senator **Boschwitz**. That is predicated on spending. I think some members of the committee might consider that delay of the implementation of the third phase of the tax cut. We would want to see what kind of impact some of our colleagues want to make on the spending side and not try to raise money for the purpose of trying to balance the budget. It has been my experience in the years that I have been here, we raise $1, we spend about $1.10.

I would not be very optimistic about the ability to balance the budget by raising taxes.

Dr. **Walker**. If that could not be done in one package with the spending reduction as an integral part of it, then I would withdraw support for any tax increases. I agree with you fully.

Senator **Boschwitz**. Mr. Sunley, I have your testimony also. Why don't you go ahead. It is quite extended, summarize it the way you can, read it if you feel you must in order to make the points you wish.

STATEMENT OF EMIL M. SUNLEY, DIRECTOR OF TAX ANALYSIS, DELOITTE HASKINS & SELLS

Mr. **Sunley**. Thank you, Senator Boschwitz. It is a pleasure to be before this committee today to present testimony on tax expenditures.

I will follow your suggestion and summarize some of the points in my testimony, mainly the first half.

CONSTITUTIONAL AMENDMENT COULD ENCOURAGE EXPANSION OF TAX EXPENDITURES

If Congress is ever going to get control of the deficit, attention must be paid not only to direct expenditure programs but also to the many indirect programs administered through the tax system. Tax expenditures, like direct expenditures, should be subject to careful scrutiny to insure that they meet important national needs in an efficient manner.

I might say at the outset that the proposed constitutional amendment for a balanced budget and a limitation on taxation, S.J. Res. 58, if adopted, could encourage the expansion of tax expenditures. This amendment in section 1 would mandate that prior to each fiscal year Congress adopt a budget statement under which outlays would not exceed receipts. In addition, section 2, would provide that the annual increase in planned or budgeted receipts would be limited to the rate of growth in national income in the preceding calendar year. Thus, taking the two sections together, the growth of Federal spending would be limited to the growth of national income. If Congress would have to reduce revenues to meet the requirements of section 2, there is nothing in the amendment to prohibit Congress from enacting new tax expenditures which would, in effect, increase Government spending through the tax system while at the same time reducing revenue. This would seem to me to be a serious defect in S.J. Res. 58 if its purpose is to limit the size of Government.

I have been asked by the committee staff today to focus on (1) the relation of tax expenditures to the proposed minimum tax and safe-harbor leasing and (20) on the treatment of tax expenditures in this year's budget.

MINIMUM TAX REPRESENTS BAD ECONOMIC POLICY

With respect to a minimum tax, design of a minimum tax requires decisions on how each tax expenditure will be treated under this tax compared to the regular tax. But before discussing the administration's proposal for an alternative minimum tax for corporations, I should make it clear that I am not an enthusiast of it. The alternative minimum tax represents bad economic policy and bad tax policy. If enacted, it would place a high premium on a careful timing of tax deductions and credits. The tax would encourage tax-induced mergers that serve no useful purpose and would reduce the effectiveness of incentives provided by the Economic Recovery Tax Act of 1981.

The administration has proposed to repeal the add-on minimum tax for corporations and to replace it with an alternative minimum tax. Corporations would be required to pay the greater of their regular income tax or an alternative tax equal to 15 percent of their alternative tax base in excess of $50,000. This alternative tax base would consist of regular taxable income before the net operating loss deduction plus certain tax preferences. No tax credits, other than the foreign tax credit, would be allowed against the alternative tax. The amount of the alternative tax in excess of the regular tax would be allowed as a credit against the regular tax in future years. There are 14 such items.

This list of tax preferences includes every significant corporate tax expenditure which is a special exclusion, exemption or deduction from gross income or deferral of tax liability except: One, deferral of income of controlled foreign corporations; two, expensing of research and development expenditures; three, deductibility of noncash patronage dividends of cooperatives; four, deductions for charitable contributions; and five, expensing of construction period interest and taxes. The last of these tax preferences would be repealed—except for residential construction—under a separate administration proposal to require that corporations capitalize interest and taxes incurred in the construction of nonresidential buildings.

The list of tax preferences also includes three items that are not included on the tax expenditures list presented in Special Analysis G of the Budget. These items are: One, deductions for debts to buy or carry tax-exempt securities; two, excess interest on original discount bonds; and three, deductions for certain costs incurred with respect to long-term contracts.

Whether or not these items should be considered tax expenditures is discussed in appendix A.

CORPORATE TAX EXPENDITURES AFFECTED BY ADMINISTRATION'S PROPOSAL

Although under the administration's proposal, corporate tax expenditures which represent a special credit or a preferential rate of tax are not added back to taxable income, these tax expenditures are affected by the administration's proposal. For example, the corporate capital gains preference, which is a preferential rate of tax, is not added back since the full amount of net long-term capital gain would already be included in corporate taxable income. Also, the only tax credit that is allowed against the alternative minimum tax liability is the foreign tax credit. The proposed minimum tax, if enacted, would reduce, in effect, the limitation on the investment tax credit from 90 to 67.4 percent of regular tax. This particular aspect of the minimum tax represents almost half of the revenue gain from this proposal. Congress simply by reducing the limitation on the tax credit to 67.4 percent of tax would be able to increase Federal revenues by about one-half of the amount of what would be raised by the rather complicated proposal for an alternative minimum tax. This investment credit would blunt the incentive effect of the investment credit and would increase the need to lease by companies subject to the alternative tax.

Under the administration's proposal for an alternative minimum tax the net operating loss deduction is treated, in effect, as a tax preference since the deduction is not allowed for purposes of the minimum tax. As a result companies may be subject to the minimum tax even though over a period of years they have had no economic profits and thus owe no regular tax.

In summary, in designing an alternative minimum tax one must focus on how each tax expenditure will be treated under that tax.

The administration's proposal affects virtually every corporate tax expenditure. It also would produce unwarranted tax results, reducing the incentive effect of the capital recovery rules enacted just last year.

SAFE-HARBOR RULES ARE A TAX EXPENDITURE

Turning now to safe-harbor leasing, the new safe-harbor leasing rules facilitate the transfer of tax benefits from a company that currently cannot use them to a company that can. The user of the property—or the seller of the tax benefits—receives a significant portion of the tax benefits through reduced rental charges and/or cash payments.

The basic tax policy issue is fairly simple. No Congressman would propose a program to encourage investment that discriminates against rapidly growing businesses, firms that temporarily have fallen on hard times, or certain industries threatened by foreign competition, and as a side effect encourages tax-induced takeover and mergers. Without some form of transferability or refundability, the acclerated cost recovery system and the investment tax credit would have just these effects.

The safe-harbor rules are clearly a tax expenditure since they provide special deductions and credits for the lessor. The general tax rules would only permit the lessee to claim the deductions and credits since it is the lessee who is the actual user and owner of the machinery and equipment. The pre-1981 leasing rules, however, should not be considered to be a tax expenditure since their purpose is to distinguish true leases from leases that are, in reality, sales.

Mr. Chairman, the final portion of my testimony reviews this year's special analysis G. I discuss four items. First, the use of the term "tax subsidies" compared to "tax expenditures." I must say that I find the term "tax subsidies" to be a more perjorative term than "tax expenditures," which seems to be a broader term covering both tax incentives and hardship relief provisions.

I find it somewhat difficult to consider the extra exemption for the blind as a subsidy. I doubt that we are really trying to encourage blindness.

Second, I also review at some detail the various items that were included or dropped this year from the list of tax expenditures compared to the previous year. The Joint Committee on Taxation on March 8 released its estimate of Federal tax expenditures and they included 14 items on their list that were not included in the special analysis G in this year's budget. I list those items on pages 13 and 14 of my testimony. In appendix B to my testimony I discuss the rationale for classifying each of these items as a tax expenditure.[1]

Third, I suggest that separate estimates should be provided for individuals and corporations. This has traditionally been the case, and it is also what the Joint Committee did in its release on March 8.

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[1] See p. 319.

Finally, I discuss the difference between the usual tax expenditure estimates which are essentially revenue cost estimates and the outlay equivalent estimates.

I would be pleased to go into greater detail in any of those items if you would like me to. But this would conclude my oral statement.

Senator BOSCHWITZ. Thank you.

PREPARED STATEMENT OF EMIL M. SUNLEY, DIRECTOR OF TAX ANALYSIS, DELOITTE HASKINS & SELLS

I am Emil M. Sunley, Director of Tax Analysis at Deloitte Haskins and Sells, an international accounting firm. I am most pleased to have been invited to present testimony today on tax expenditures.

Since the first tax expenditure budget was published by the Treasury Department in 1968, the concept of tax expenditures has gained wide acceptance in the United States and abroad. It is now generally recognized that many provisions of the Internal Revenue Code are intended as tax incentives or hardship relief provisions. These special provisions have objectives similar to expenditure programs funded through appropriations.

The congressional Budget Act of 1974 includes the concept of tax expenditures in the new budget process, and it requires a listing of tax expenditures in the Budget.

The act defines tax expenditures as "revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

If Congress is ever going to get control of the deficit, attention must be paid not only to direct expenditure programs but also to the many indirect programs administered through the tax system. Tax expenditures, like direct expenditures, should be subject to careful scrutiny to insure that they meet important national needs in an efficient manner.

I might say at the outset that the proposed Constitutional amendment for a balanced budget and a limitation on taxation (S.J. Res. 58), if adopted, could encourage the expansion of tax expenditures. This amendment in section 1 would mandate that prior to each fiscal year Congress adopt a budget statement under which outlays would not exceed receipts. In addition, section 2 would provide that the annual increase in planned or budgeted receipts would be limited to the rate of growth in national income in the preceding calendar year. Thus, taking the two section together, the growth of federal spending would be limited to the growth of national income. If Congress would have to reduce revenues to meet the requirement of section 2, there is nothing in the amendment to prohibit Congress from enacting new tax expenditures which would, in effect, increase government spending through the tax system while at the same time reducing revenue. This would seem to be a serious defect in S.J.Res. 58 if its purpose is to limit the size of government.

I have been asked today to focus on (1) the relation of tax expenditures to the proposed minimum tax and safe-harbor leasing and (2) on the treatment of tax expenditures in this year's Budget.

Minimum Tax

Design of a minimum tax requires decisions on how each tax expenditure will be treated under this tax compared to the regular tax. But before discussing the Administration's proposal for an alternative minimum tax for corporations, I should make it clear that I am not an enthusiast of it. The alternative minimum tax represents bad economic policy and bad tax policy. If enacted, it would place a high premium on a careful timing of tax deductions and credits. The tax would encourage tax-induced mergers that serve no useful purpose and would reduce the effectiveness of incentives provided by the Economic Recovery Tax Act of 1981. Specifically the tax would, in effect, reduce the amount of the investment tax credit that is currently useable, increasing the need for safe-harbor leasing. It would also undermine ACRS deductions when such deductions give rise to a net operating loss deduction which is not allowed in computing the minimum tax. By enacting a minimum tax, Congress is saying that if a business engages only a little in activities encouraged by tax subsidies, such as drilling oil wells, leasing, or exporting, no minimum tax is imposed. But if the business is good at these activities and specializes in them, it will have to pay the minimum tax, putting it at a competitive disadvantage.

The Administration has proposed to repeal the add-on minimum tax for corporations and to replace it with an alternative minimum tax. Corporations would be required to pay the greater of their regular income tax or an alternative tax equal to 15 percent of their alternative tax base in excess of $50,000. This alternative tax base would consist of regular taxable income before the net operating loss deduction plus certain tax preferences. No tax credits, other than the foreign tax credit, would be allowed against the alternative tax. The amount of the

DESCRIPTION	CORP.*	IND.*	YEAR OF REVIEW BY HOUSE WAYS AND MEANS COMMITTEE							
			'74	'75	'76	'77	'78	'79	'80	'81
Health:										
Exclusion of employer contributions to medical insurance** programs and medical care		x						x		
Deductibility of medical expenses		x					x	x		
Income security:										
Exclusion of social security benefits:										
Disability insurance benefits		x						x	x	
OASI benefits for aged		x					x	x		
Benefits for dependents and survivors		x						x		
Exclusion of railroad retirement system benefits		x						x		
Exclusion of sick pay		x		x						
Exclusion of unemployment insurance benefits		x					x			
Exclusion of workman's compensation benefits**		x								
Exclusion of public assistance benefits**		x								
Net exclusion of pension contributions and earnings:										
Employer plans		x			x		x			
Plans for self-employed and others		x			x		x			
Exclusion of other employee benefits:										
Premiums on group term life insurance		x					x			
Premiums on accident and accidental death insurance**		x								
Privately financed supplementary unemployment benefits		x					x			
Meals and lodging		x					x	x		
Exclusion of capital gains on house sales if over 65		x					x			
Excess of percentage standard deduction over minimum standard deduction		x		x	x	x	x	x		
Additional exemption for the blind		x					x			
Additional exemption for over 65		x					x			
Retirement income credit		x		x		x	x			
Earned income credit		x		x			x	x		
Veterans' benefits and services:										
Exclusion of veterans' disability compensation		x		x						
Exclusion of veterans' pensions		x		x						
Exclusion of GI bill benefits		x		x						

DESCRIPTION	CORP.*	IND.*	YEAR OF REVIEW BY HOUSE WAYS AND MEANS COMMITTEE '74	'75	'76	'77	'78	'79	'80	'81
General government:										
Credits and deductions for political contributions		x		x			x			
Revenue sharing and general purpose fiscal assistance:										
Exclusion of interest on State and local debt	x	x						x		
Exclusion of income earned in U.S. possessions	x	x			x					
Deductibility of nonbusiness State and local taxes (other than on owner-occupied homes and gasoline)		x					x			
Business investment:										
Depreciation on rental housing in excess of straight line 2/	x	x		x			x			
Depreciation on buildings (other than rental housing) in excess of straight line 2/	x	x		x			x			x
Expensing of research and development expenditures**	x									
Capital gains: corporate (other than farming and timber)	x						x			
Investment credit	x	x		x	x		x	x		x
Asset depreciation range 2/	x	x					x			x
Personal investment:										
Dividend exclusion		x				x	x			x
Capital gains: individual (other than farming and timber)		x					x			x
Exclusion of capital gains at death		x			x		x	x		
Exclusion of interest on life insurance savings		x					x			
Deferral of capital gain on home sales		x					x			x
Deductibility of mortgage interest on owner-occupied homes		x						x		
Deductibility of property taxes on owner-occupied homes		x						x		
Deductibility of casualty losses		x					x			
Other tax expenditures:										
Exemption of credit unions	x						x			
Deductibility of charitable contributions (other than education)	x	x					x			x
Deductibility of interest on consumer credit		x		x						
Maximum tax on earned income		x		x			x			

*Corp. - Corporation
*Ind. - Individual
**Tax Expenditures not reviewed (1974-1979)
2/ Accelerated depreciation is no longer considered a tax expenditure. The 1983 Special Analysis G omits depreciation.

Summary of Tax Expenditure Review (1974-1979)
68 of 74 reviewed
12 of 13 Corporate only reviewed
16 of 16 Corporate & Individual reviewed
41 of 45 Individual only reviewed

alternative tax in excess of the regular tax would be allowed as a credit against the regular tax in future years.

The specific tax preferences to be added back are:

1) excess percentage depletion;

2) accelerated depreciation on real property,

3) amortization of certified pollution control facilities,

4) amortization of child care facilities,

5) reserves for losses on bad debts of financial institutions,

6) intangible drilling costs,

7) mining exploration and development costs,

8) lessors' leasing benefits,

9) deductions for debts to buy or carry tax-exempt securities,

10) deferred DISC income,

11) certain shippping income,

12) amortization of motor carrier operating rights,

13) excess interest on original discount bonds, and

14) deductions for certain costs incurred with respect to long-term contracts.

This list of tax preferences includes every significant corporate tax expenditure which is a special exclusion, exemption or deduction from gross income or deferral of tax liability except 1) deferral of income of controlled foreign corporations, 2) expensing of research and development expenditures, 3) deductibility of noncash patronage dividends of cooperatives, 4) deductions for charitable contributions and 5) expensing of construction period interest and taxes. The last of these tax preferences would be repealed (except for residential construction) under a separate Administration proposal to require that corporations capitalize interest and taxes incurred in the construction of nonresidential buildings.

The list of tax preferences also includes three items that are not included on the tax expenditures list presented in Special Analysis G of the Budget.[1] These items are:

1) deductions for debts to buy or carry tax-exempt securities,
2) excess interest on original discount bonds, and
3) deductions for certain costs incurred with respect to long-term contracts.

Whether or not these items should be considered tax expenditures is discussed in Appendix A.

Although under the Administration's proposal tax expenditures which represent a special credit or a preferential rate of tax are not added back to taxable income, these tax expenditures are affected by the Administration's proposal. For example, the corporate capital gains preference, which is a preferential rate of tax, is not added back since the full amount of net long-term capital gain would already be included in corporate taxable income. Also, the only tax credit that is allowed against the alternative minimum tax liability is the foreign tax credit.[2] The proposed minimum tax, if enacted, would reduce, in effect,the limitation on the investment tax credit from 90 to 67.4 percent of regular tax.[3] This would blunt the incentive effect of the investment credit and would increase the need to lease by companies subject to the alternative tax.

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[1] The Administration considers the amortization of motor carrier operating licenses to be a tax expenditure but classifies it under Income Security instead of Transportation.

Under the Administration's proposal for an alternative minimum tax the net operating loss deduction is treated, in effect, as a tax preference since the deduction is not allowed for purposes of the minimum tax. As a result companies may be subject to the minimum tax even though over a period of years they have had no economic profits and thus owe no regular tax.

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[2] The foreign tax credit has never been considered a tax expenditure since this credit prevents the double taxation of income earned abroad. Senator Dole has suggested, according to newpaper reports, that foreign taxes be allowed only as a deduction under a corporate minimum tax. This harsh treatment would violate basic principles of international taxation.

[3] A corporation subject to the 90 percent limitation pays an effective tax rate on taxable income equal to 4.6 percent. The alternative minimum tax would raise the effective tax rate to 15 percent. Thus the investment tax credit cannot reduce the effective rate by more than 67.4 percent ((46% - 15%)divided by 46%).

Also, the proposed rule for net operating losses can blunt the incentive effects for ACRS deductions. Consider a company that makes a major investment in year one. The ACRS deductions produce net operating losses in years one through five. Then in years six through ten the firm has regular taxable income before the net operating loss carryover since no further depreciation deductions are allowed. No regular tax is due because of the net operating loss carryover. This company, however, would be subject to the minimum tax under the Administration's proposal. One must wonder why the Administration has proposed a minimum tax that undermines the Accelerated Cost Recovery System of depreciation.

I would conclude that the net operating loss deduction is not a preference, and it should be allowed for purposes of the alternative minimum tax. Certain adjustments, however, would be required to take into account tax preferences in prior years that increased the size of the NOL. Thus, the NOL for the alternative tax would differ from the NOL for the regular tax, and separate carryback and carryover accounts would be required.

In summary, in designing an alternative minimum tax one must focus on how each tax expenditure will be treated under that tax. The Administration's proposal affects virtually every corporate tax expenditure. It also would produce unwarranted tax results, reducing the incentive effect of the capital recovery rules enacted just last year.

Safe-Harbor Leasing

The new safe-harbor leasing rules facilitate the transfer of tax benefits from a company that currently cannot use them to a company that can. The user of the property (or the seller of the tax benefits) receives a significant portion of the tax benefits through reduced rental charges and/or cash payments.

The basic tax policy issue is fairly simple. No Congressman would propose a program to encourage investment that discriminates against rapidly growing businesses, firms that temporarily have fallen on hard times, or certain industries threatened by foreign competition, and as a side effect encourages tax-induced takeover and mergers. Without some form of transferability or refundability, the Accelerated Cost Recovery System and the investment tax credit would have just these effects.

The safe-harbor rules are clearly a tax expenditure since they provide special deductions and credits for the lessor. The general tax rules would only permit the lessee to claim the deductions and credits since it is the lessee who is the actual user and owner of the machinery and equipment. The pre-1981 leasing rules, however, should not be considered to be a tax expenditure since their purpose is to distinguish true leases from leases that are, in reality, sales.

Special Analysis G in FY 1983 Budget

The current Administration has recast Special Analysis G, the tax expenditure portion of the Budget. This is not too surprising given that some current Treasury officials are not sympathetic to the generally accepted structure of an income tax. What may be surprising is how little Special Analysis G has changed, particularly after one gets past the super-charged rhetoric of the first couple of pages. I would like to comment here on four areas:

1) the term "tax subsidies" versus "tax expenditures",

2) the items included or dropped from the list,

3) separate estimates for individuals and corporations, and

4) the outlay equivalent estimates.

The Administration argues that the term "tax expenditures" is unfortunate and misleading. Instead, it adopts the term "tax subsidies." The definition of tax subsidies relies on the distinction between the "normal" or "reference" provisions of the tax structure and "special" provisions which are exceptions. In short, the definition of tax subsidies is for all practical purposes virtually the same as the traditional definition of tax expenditures.

I would suggest that the term "tax subsidies" is more pejorative than "tax expenditures" which seems to me to be a broader term covering both tax incentives and hardship relief provisions. I find it difficult to consider the extra exemption for the blind a subsidy. Are we trying to encourage blindness?

In identifying tax subsidies the Administration suggests that two conditions are necessary:

1) The provision must be "special" in that it applied to a narrow class of transactions or taxpayers; and

2) There must be a "general" provision to which the "special" provision is a clear exception.

Though this criteria, or a version of it, was not employed in prior years, 88 percent of the items from last year's list are included this year.

The Joint Committee on Taxation on March 8 released its estimates of federal tax expenditures. They included fourteen items on their list that were not included in Special Analysis G. The items are:

- ACRS provisions
  - accelerated depreciation in equipment
  - depreciation on rental housing in excess of straight-line
  - depreciation on buildings other than rental housing in excess of straight-line;
- reduced rates on the first $100,000 of corporate income,
- deferral of income of controlled foreign corporations,

- -- capital gains at death[4]
- -- deductibility of patronage dividends and certain other items of cooperatives,
- -- exclusion of certain agricultural cost sharing payments,
- -- exclusion of payments in aid of construction of water, sewage, gas, and electric utilities,
- -- exclusion of public assistance benefits,
- -- exclusion of scholarship and fellowship income, and
- -- allocation of research and development costs to U.S.-source income,
- -- deduction for two-earner couples,
- -- exclusion of employer provided child care.

The last three of these items are new tax expenditures added by the Economic Recovery Tax Act of 1981. The other items were included in last year's Special Analysis G. Appendix B discusses the rationale for classifying each of these items as a tax expenditure.

In this year's Special Analysis G, in contrast to last year's, the estimates for the revenue cost (and outlay equivalents) of tax expenditures is not broken down between individuals and corporations. This is consistent with the treatment outlays which are reported by function but not by whether the payee is a person or a corporation. However, receipts and the impact of tax proposals are reported in the budget by source, and, it seems to me, that tax expenditures should also be reported by source since they occur on the revenue side of the budget. If one wants to consider an alternative minimum tax for corporations, one needs data on corporate tax expenditures. The prior practice of separating tax expenditures by individuals and corporations should be continued. The Joint Committee on Taxation did so.

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[4] Carryover basis of capital gains at death is considered a tax expenditure in Special Analysis G

The final topic I wish to discuss is outlay equivalents. In last year's Special Analysis G, estimate of outlay equivalents were given for the tax expenditures classified under the housing and energy functions. This new term and concept was introduced because the traditional estimates of tax expenditures are not comparable to estimates for direct outlays contained elsewhere in the Budget. Direct expenditures typically represent pre-tax dollars; that is, direct spending generates taxable wages, interest, rents, and profits. Tax expenditure estimates, in contrast, are measured in after-tax dollars. They represent the tax savings to the taxpayer which normally differs from the (taxable) payment that would be required under a direct spending program to generate the same after-tax income and hence the same incentive effect.

Presenting both tax expenditure estimates and outlay equivalent estimates may lead to some confusion, but this should decrease over time. The traditional tax expenditure estimates are the more relevant when one is interested in the revenue cost of various tax preferences; that is, in the impact of the tax expenditure on the deficit. The outlay equivalent estimates are the more relevant when one is comparing tax preferences with direct expenditures. Having developed outlay equivalent estimates this year for all tax expenditures, the Administration has been able to give outlay equivalent estimates in Part V of the Budget where direct expenditures by function are discussed. For the first time it is possible to compare the amount of direct expenditures and the outlay equivalents of tax expenditures for, for example, national defense or agriculture.

Conclusion

Though the concept of tax expenditures has been controversial, it is now widely accepted. Tax expenditures must be carefully examined if Congress is going to get control over the budget. Also, when one designs an alternative minimum tax one must consider how each tax expenditure under the regular tax is going to be treated under the minimum tax. The President's proposed alternative minimum tax deals its greatest blow to investment tax credit and the net operating loss deduction which is not a tax expenditure.

This year's Special Analysis G represents a departure from those issued previously. The term "tax subsidy" is substituted for "tax expenditure." Some items are dropped from the list. The breakdown between corporations and individuals is omitted. The outlay equivalent section is expanded.

Appendix A

Tax Preferences for Minimum Tax Not Included in Administration's Tax Expenditure List

1. Interest on debt to carry tax-exempt securities

Adding back the deductions for debts to buy or carry tax-exempt securities indirectly gets at the exclusion of interest on State and local debt which is considered to be a tax expenditure. Presumably the Administration decided for political (and possibly Constitutional) reasons to add back the cost of carrying tax-exempt securities rather than the exempt interest itself.

2. Excess interest on original issue discount

The Internal Revenue Code allows a deduction for interest paid or accrued within the taxable year on indebtedness. The treatment of original issue discount is not provided for in the Code._/ Instead, the Income Tax Regulations on the deductibility of interest (section 1.163-4) provide that original issue discount on corporate bonds is deductible as interest and shall be prorated or amortized over the life of the obligation. This is

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_/ In contrast, Section 171 of the Code provides for amortization of bond premimum.

clearly a generous rule since on an actuarial basis the interest expense is much lower during the early years of the bond.

The treatment of original issue discount has not been considered to be a tax expenditure since it is provided in the regulations. In general it is assumed that regulations interpreting statutory provisions do not give rise to tax expenditures. The presumption is that the regulations reflect the general rules and, therefore, can not provide a special deduction or exclusion, etc. However, where regulations are technically incorrect and they are defended on nontechnical grounds, they may give rise to a tax expenditure.

3. Deductions for certain costs of long-term contracts.

The deduction for certain costs incurred with respect to long-term contracts is the third non-tax expenditure item added back as a tax preference under the Administration's proposal. Like the second item, this preference is not a special deduction or exclusion allowed by the Code. Instead, the accounting treatment of long-term contracts is provided by the regulations interpreting the general rule for the inclusion of income (section 1.451-3).

Appendix B

Tax Expenditures Included in the Joint Tax Committee list But Not in Special Analysis G

ACRS provisions

The Administration concluded that the ACRS provisions do not result in a "tax subsidy" since these provisions now constitute the general income tax rules for determining how the cost of depreciable assets is recovered. Yet special rules are provided for compution depreciation for purposes of earnings and profits. Also, the Administration recognizes that the ACRS provisions are important as investment incentives even though they are not tax subsidies. In prior years the 20 percentage range under the ADR system and the excess of accelerated over straight-line depreciation were considered tax expenditures.

Reduced rates on first $100,000 of corporate income

Graduated corporate tax rates are now considered part of the normal tax structure. In prior years, corporate tax rates below 46 percent were assumed to give rise to a tax expenditure. Graduated rates have generally been justified as a subsidy for small business, and this would suggest that they should be included on the tax expenditure list.

Deferral of income of controlled foreign corporations

This item has been included on the tax expenditure lists except the 1976 Budget list (in January 1975), the 1977 Budget list (in January 1976), and the 1978 Budget list (in January 1977). When this item has been included on the list, deferral has been viewed as an exception to the basic precept of our tax system that U. S. corporations and citizens are subject to tax on their worldwide income when earned. When it has been excluded, it has been argued that deferral is in accord with international norms of taxation.

Capital gains at death

The previous Administration assumed that under the normal tax system unrealized gains would be taxed at death. This year the assumption about the normal tax structure is that the basis of the decedent should carryover to the heir. This is the rule which currently applies to lifetime gifts.

Cooperatives

The special tax treatment of cooperatives has been dropped from the list presumably because the provisions, like the rules for Subchapter S corporations, alleviate double taxation. The tax expenditure budget has not considered the Subchapter S treatment to be a tax expenditure.

Agricultural cost sharing payments

Certain payments made under various federal and state cost-sharing conservation programs may be excluded from gross income. Payments may be excluded to the extent they serve specified conservation purposes and do not substantially increse the annual income derived from the property. Given that these payments may preserve property values or prevent a decrease in the annual income derived from the property, one can conclude that these payments provide a direct benefit to the taxpayer and thus give rise to a tax expenditure.

Payments in aid of construction

Certain payments made by customers in aid of construction of water, sewage, gas, and electric utilities are excluded from income. No depreciation or investment tax credits are allowed with respect to property acquired with nontaxable contributions. This rule for utilities, which reversed Rev. Rul. 75-557, gives these utilities the same treatment for contributions in aid of construction as that generally provided for contributions to the capital of the taxpayer. Contributions in aid of construction should be considered a tax expenditure if these contributions are not truly capital contributions but instead are made in exchange for goods or services to be provided by the taxpayer.

Public assistance payments

Exclusion of public assistance payments is not considered to be a tax subsidy by the Administration since the general rule is that gifts are not taxable. However, the exclusion of unemployment and social security benefits are tax subsidies since these benefits are wage-related and are not gifts. Previous administrations have considered the exclusion of public assistance payments to be a tax expenditure but not the exclusion of in-kind benefits such as food stamps or housing assistance.

Scholarships and Fellowships

The exclusion of scholarships and fellowships is dropped from the tax expenditure list since they are similar to gifts. Yet for some fellowships the recipient agrees to perform services for the grantor and many of these fellowships were made tax-exempt by the Tax Treatment Extension Act of 1980. These fellowships ought to be considered tax subsidies even under the Administration's criteria. Also, under the Internal Revenue Code post-doc fellowships in excess of $300 a month are taxable. The Administration must view this rule as a negative tax subsidy.

Allocation of R&D

The Economic Recovery Tax act (ERTA) permits taxpayers for two years to allocate all domestic research and experimentation expenditures against U.S. source income. This item gives rise to a tax expenditure since R&D enhances foreign as well as domestic income, and therefore, a portion of these expenditures would properly be allocated against foreign source income.

Two-earner couples

The deduction for two-earner couples, added to the law by ERTA, alleviates a portion of the marriage penalty. It might be considered a tax expenditure since it only applies to earned income. The Administration considered this deduction to be part of the basic structure of income tax since it differentiates tax liabilities between different types of tax units--one-earner and two-earner families.

Employer provided child care

Under ERTA taxpayers may exclude employer provided child care assistance if the assistance is provided under a nondiscriminatory plan. These payments, absent ERTA, would be taxable as compensation. This provision was enacted as an incentive for employers to provide dependent care for their employees and it gives rise to a tax expenditure.

Senator BOSCHWITZ. Mr. Sunley, are you located here in Washington?

Mr. SUNLEY. Yes, I am associated with the national affairs office of Deloitte Haskins & Sells.

Senator BOSCHWITZ. I will have to read your statement, and I may have to call you.

Because I have to tell you that I did not understand every aspect of it. But I will read it again with greater care.

As you may know, I was until recently a very long-term client of your firm.

Mr. SUNLEY. I have been told that.

Senator BOSCHWITZ. Yes, right. If I do not understand what you say here, I will call up my friend Bassinger in Minneapolis and talk to him.

So let me review it if I may and I will review also Mr. Kurtz, your testimony.

Are you also located downtown?

Mr. KURTZ. Yes, I am.

Senator BOSCHWITZ. So that in the event I have some questions about this I will call each of you.

DISAGREE ON TAKING GREAT BIG CHUNKS

I, in looking at the budget as a whole, feel that there perhaps are some taxing expenditures. I do not agree, Mr. Walker, that we can just take great big chunks. I am not sure that there are great big chunks around to just take and thereby balance the budget.

I think that we probably have to do a series of things from the standpoint of equity, political reality and good sense.

I understand your dislike for the idea of reversing safe-harbor provisions but I believe that it will certainly be affected by the actions of Congress.

Dr. WALKER. I strongly urge a review of the safe-harbor leasing provisions. Any abuses that can be determined should be corrected.

Senator BOSCHWITZ. I thank you gentlemen for coming and participating and I will read your testimony carefully again and if I have any questions I will be back in touch.

Thank you very much.

[Whereupon, at 12:14 p.m., the committee recessed to reconvene subject to the call of the Chair.].

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APPENDIX

STATEMENT OF

THE NATIONAL ASSOCIATION OF HOME BUILDERS

BEFORE THE

COMMITTEE ON THE BUDGET

UNITED STATES SENATE

ON

THE FISCAL 1983 BUDGET

MARCH 11, 1982

Mr. Chairman and Members of the Committee:

My name is Harry Pryde and I am a homebuilder from Seattle, Washington. I am testifying today on behalf of the more than 114,000 members of the National Association of Home Builders (NAHB). Since November of last year, NAHB has suffered a loss of over 9,000 members. NAHB is a trade association of the nation's homebuilding industry, of which I am First Vice President.

Mr. Chairman, I appreciate the opportunity to appear before the Committee this morning to present our views on the Fiscal '82 and '83 budget. As you are well aware, the housing industry is in the midst of a crisis. We are in the 40th straight month of a recession for which we see no immediate end under present policies. Prolonged high interest rates have succeeded in bringing our industry to a near halt and they are now having similar effects on many other segments of our economy.

My testimony outlines in detail the housing depression.

HOUSING PRODUCTION

- New housing production in 1981 totaled 1.1 million units as against an annual need for new homes that has been estimated conservatively at 1.8 million units throughout the 1980s. Last year was the worst housing production year since 1946.
- 1982 could finish as the worst post-war production year yet. NAHB's optimistic forecast for this year holds annual production to about one million. Housing starts in February fell to a seasonally adjusted annual rate of 953,000, down 26 percent from a year earlier, and down more than 52 percent from the 2 million annual production levels in 1977 and 1978. February was the seventh consecutive month that housing starts were below the one million annual level.
- March is the 40th month of recession in housing. The previous record was set during the Eisenhower Administration when the housing recession lasted 27 months.

NEW HOME SALES

- 1981 was the worst year for new home sales since the Census Bureau began collecting statistics in 1963. Only 436,000 new homes were sole, compared to 545,000 homes in 1980 and more than 800,000 in 1977 and 1978.
- Since March 1981, annual new homes sales rates have been under the 500,000 level. In January this year, the annual sales rate of new homes ws 353,000.
- Actual sales in January nationwide were 25,000 new homes--roughly the monthly number of new homes that were sold in the West alone during 1978 and 1979. In all of the Western states, only 7,000 new homes were actually sold in January. Only 4,000 new homes were sold in the Northeastern and North Central states combined.

INTEREST RATES

- Conventional mortgage interests rates now average 17 percent. Mortgage rates at such high levels price the vast majority of potential buyers out of the market.
- Interest rates normally fall rapidly and decisively during recession, but in this downturn they have declined slowly and have remained in an historically high range. Analysts forecast that mortgage rates are not likely to drop below 15 percent this year, thereby killing off any chances for a housing recovery in 1982. The consensus is that home sales will remain at depression levels until mortgage rates drop to the 12 percent range, which by historical standards still repesents an extraordinarily high cost of home financing.
- By reducing interest rates from 16 percent to 12 percent, 4.6 million additional families could qualify for a $65,000 mortgage. At 12 percent interest rates, more than 22 percent of the nation's families have the $35,000 income needed to qualify for a modest $65,000 mortgage. At 16 percent rates, fewer than 14 percent have the $44,000 income needed to qualify for the same mortgage amount.

UNEMPLOYMENT

- Unemployment in the construction trades in February was 18.1 percent or $28,000 unemployed workers, accounting for 10 percent of the total unemployed work force. Another 200,000 skilled craftsmen could lose their jobs over the next several months.
- An estimated 200,000 self-employed people in construction-related businesses have either shut down or sharply curtailed their operations in the housing industry. Self-employed people are not counted in the Labor Department's unemployment statistics.
- Bankruptcies are up 51 percent for construction firms and 65 percent for subcontractors.
- Rising joblessness toward levels not experienced since the 1930s continues to feed the federal deficit. The Congressional Budget Office estimates that every 1 percent increase in unemployment costs the Treasury $25 billion -- $19 billion in lost revenue and $6 billion in new expenditures to pay for unemployment programs.

U.S. vs THE WORLD

New housing production in the United States is outdistanced by almost every industrialized nation and the Soviet Union. Among the major Western nations only Great Britain has recently been investing less in its housing stock than the U.S.

- In 1946, almost 8 housing units were produced per thousand of U.S. population. Last year, the U.S. rate fell to less than 5 starts per thousand. In the U.S.S.R. last year, housing production was reported at 8 units per thousand.
- 1981 housing production in Japan was higher than in the U.S., even though it has roughly one-half the population. And they thought they were in the midst of a downturn!
- Private residential investment in 1980 was only 4 percent of our nation's Gross National Product, compared to 6.8 percent in France and West Germany, 6.5 percent in Japan, 5 percent in Italy and 4.8 percent in Canada.
- According to the Federal Reserve Board, housing's share of the credit markets has declined from 31 percent in the 1950s and about 25 percent in the 1960s and 1970s to only 12.1 percent in 1981. By comparison, the federal government's share has increased from 7.7 percent in the 1950s to almost one-third last year.

FISCAL POLICY

The spectre of continuing high interest rates is sustained by the ever growing federal budget deficits. And, as interest rates stay high, the more difficult it becomes to reduce the federal deficit. The thought of a $100 billion plus deficit for the coming fiscal year is only made worse by prospects of over $400 billion in deficits for fiscal years 1984 and 1985. With this disastrous outlook, it is imperative that actions be taken to reduce the federal deficit.

We believe there is no alternative to bringing down the growth of federal spending across the board. We do not believe the Administration's budget proposal goes far enough in reducing the deficit.

No programs, including defense and entitlements, should be excluded. Also, if it proves necessary, deferral of the recent tax reduction should be considered along with measures to raise revenues through increased taxes.

The action of this Committee with respect to fiscal policy will have a significant effect on the future of the homebuilding industry and our overall economy.

We urge this Committee to look at all practical options to reduce the federal deficit and the overwhelming volume of deficit financing.

There have been a number of credible alternative budget proposals from both political parties proposed in the Congress in recent weeks aimed at reducing the projected federal deficits. It is not our intent to endorse a specific proposal at this hearing but rather to urge this Committee and all Members of Congress to put partisanship aside to come up with a workable plan to reduce the deficit. We would hope that a bipartisan effort could produce results soon.

EMERGENCY RELIEF

Mr. Chairman, even with a concerted effort by the Congress and the Administration to put this country back on a stable economic game plan, results will not be immediate. A trend in reduced federal deficits leading to a balanced budget is a long term solution. What is also needed is an emergency program that will take effect this year.

Homebuilding is a unique industry. We have the land, labor, materials and market that can help turn this economy around. We are the one industry that can break the logjam of bad economic news and put America back to work.

Seven times since World War II, the housing industry has led the economy out recessionary periods. This will not happen this year under present policies. What is needed is a program to help restore a reasonable level of housing production that will put people back to work, increase federal revenues and help lead the country out of the recession.

NAHB strongly supports S. 2226, introduced by Chairman Richard Lugar of the Senate Housing Subcommittee which would provide such a stimulus. This legislation has received bipartisan support. In the House, Representatives Patterson (D-CA) and AuCoin (D-OR) have introduced similiar legislation. The Lugar bill would begin a revitalization of the housing industry and the economy through a mortgage interest buy-down plan. Under the program, the federal government would reduce the interest rate on new home mortgages by up to 4 percent for five years. The reduced interest rates would enable millions of additional families to qualify for homeownership. A unique feature of the plan is the growing equity feature where the annual mortgage payments would increase by an affordable amount over a five year period. The increases would be applied towards the principal as opposed to interest, enabling the loan to be paid off in a shorter period of time.

The program is designed to enable 450,000 newly constructed single-family homes to be produced this year. The program would also put people back to work this year. About 700,000 man-years of employment including employment in construction, land development, manufacturing, mining, transportation, wholesale trade, and other industries could result.

The five year authorization for the program of $5.2 billion will be recaptured, that is, paid back to the government upon sale of the home. The costs will be further offset by over $1 billion in tax revenues, including federal personal income tax, corporate income tax, state personal income tax, local property taxes and social security taxes generated in the first year of the program. The secondary impacts would be even more significant, but are difficult to calculate in dollars. These include reductions in unemployment compensation, food stamps and other public assistance payments.

Mr. Chairman, the primary point I make regarding this legislation is timing. Congress must act immediately so that this stimulus can begin to take effect during this year's building season. In order to allow builders time to plan and work, such a program would have to be in place and activated by June of this year. We urge the Budget Committee to include authority for this critical program in its budget ceilings.

FHA/VA/GNMA CREDIT PROGRAMS

Mr. Chairman, I cannot over-emphasize the importance of the FHA insurance, VA-guarantee and GNMA mortgage-backed securities programs. Since the creation of the FHA in 1934, more than 16 million homes have been purchased with low downpayment mortgages insured by the federal government at no cost to the public. Obviously, this is the worst time to restrict government credit for housing given the conditions of the housing and mortgage finance market. FHA and VA represent the only sources of low-downpayment, fixed-rate long-term mortgages available today and throughout the housing cycle. GNMA is essential to provide the capital necessary to finance these loans. We should certainly not turn away from the proven GNMA program in today's environment, while we continue to work for an acceptable conventional mortgage-backed security program. Therefore, we strongly endorse a maximum FHA authority of at least $40 billion and GNMA authority of at least $68.25 billion for FY'83. In addition, we will oppose any Administration proposal to restrict FHA activity to first-time homebuyers or inner-city residents. Such proposals are not in the interest of maintaining the actuarially sound and successful FHA program that we will continue to need in the future.

MULTIFAMILY RENTAL HOUSING

Regarding multifamily production, I believe that the most significant action that could be taken to create jobs and stimulate construction would be to push out the HUD and Farmers Home pipeline as quickly as possible. I am referring to Section 8, Section 202, Section 515, tandem and public housing construction. Mr. Chairman, I recognize that this would represent an almost 180° reversal for the Administration. But the pipeline is the only source of multifamily production that could move this year and have an impact on employment and the overall economy.

It is our understanding that there are over 150,000 units in the Section 8 pipeline alone. Some 35,000 units are reserved for state housing finance agencies and would be financed by mortgage revenue bonds. With continued high interest rates, these projects would need a sufficient financing adjustment factor in order to be financially viable. In addition, some 33,000 units of housing for the elderly and handicapped have direct loan commitments under the Section 202 program. Almost 5,000 units should be developed in rural areas under the Section 515 rural program. Finally, most of the remaining units with FHA-insured mortgages will need GNMA tandem financing in order to proceed.

Beyond the stimulus effect of moving the pipeline, such action would keep faith with commitments made by HUD to owners and developers. Based upon these commitments, project sponsors have allocated funds toward development of final working drawings, engineering costs and other pre-development expenses. These brave souls have labored through the time-consuming and expensive process of bringing a government-assisted housing proposal to fruition.

Mr. Chairman, if these commitments are rescinded retroactively, the only beneficiaries will be the housing attorneys in Washington who will litigate the legality of such actions for years in the future. The greatest damage, of course, would be caused to the lower income families and elderly who would be denied decent housing.

Mr. Chairman, realistic remedies to address the multifamily pipeline would require budgetary authority for a realistic financing adjustment factor for Section 8, funding for GNMA tandem programs, and the ability to adjust Section 8 contract authority for projects whose feasibility was determined at 1980 hard construction cost levels. NAHB supports efforts to maintain elderly housing production with feasible interest rate levels.

Mr. Chairman, we would suggest that consideration be given to accelerating movement in the pipeline through FY'82 supplemental funding for the GNMA tandem programs. A reduction in the use of Section 8 new and substantial rehabilitation FY'82 budget authority could provide $1 billion for GNMA tandem financing in FY'82 as well as a minimum of $3.6 billion of financing adjustment factor funds calculated at a more realistic 13 percent interest rate ceiling. We support the action taken last week by the HUD-Independent Agencies Appropriations Subcommittee to make these projects financially feasible in response to the Administration's rescission request.

RURAL HOUSING

Mr. Chairman, over 200 rural builders came to Washington recently representing many other builders who could not afford the trip. Their message was simple and direct -- the Farmers Home housing programs represent the only source of mortgage credit in over half of the counties in rural America. FmHA is the only effective delivery system of mortgage credit for many rural areas. The Administration's proposed FY'83 budget for these programs bring them one step closer to elimination. It seems clear that FY'84 would see the end of the Section 502 and 515 programs, with no alternative method of financing being proposed. Proposals to convert the construction programs of FmHA into a housing block grant administered by the state disregards the workability of these programs and the generally effective delivery system in place through FmHA offices. As shown in the following chart, the proposed cuts by the Administration would decimate these essential programs.

	FY'82	FY'83 Proposed	% Cut
Section 502 Single Family Low Income	$2.3 billion 67,500 units	$900 million 200,000 units	61%
Section 502 Moderate	$429 million 11,700 units	-0-	100%
Section 515 Rental	$940 million 29,400 units	$200 million 5,740 units	79%
Rural Rental Assistance	$398 million 30,740 units	$185 million 6,830 units	54%
Total New Units	108,600	25,840	67%

Mr. Chairman, we strongly support a level of funding in FY'83 for rural progams that would essentially maintain the FY'82 funding levels. In addition, we support a sufficient level of rental assistance funds to make Section 515 production feasible. All of the FmHA housing programs should remain available for rural communities of 10,000 to 20,000 whose demand for mortgage credit is today greater than ever.

CONCLUSION

In concluding my statement, Mr. Chairman, I stress that the housing industry and our national economy are at the mercy of the Congress and the Administration. It is in your power to make room in the budget for an emergency stimulus, such as S. 2226, to generate some positive economic activity this year. I urge this Committee and the Congress to recognize both the short and long term problems facing our economy. I am most grateful for the opportunity to appear before you today, and would be pleased to answer any questions.

STATEMENT
on behalf of the
NATIONAL ASSOCIATION OF REALTORS®
regarding
IMPACT OF FEDERAL BUDGET ACTIONS ON THE HOUSING AND MORTGAGE MARKETS
to the
SENATE BUDGET COMMITTEE
by
DR. JACK CARLSON
March 11, 1982

I am Jack Carlson, Executive Vice President and Chief Economist of the NATIONAL ASSOCIATION OF REALTORS®.

On behalf of the nearly 700,000 members of the National Association, we greatly appreciate the opportunity to present our views on the impact of federal budget policies on the housing and mortgage markets.

For forty months now, housing activity has steadily declined, and this decline has accelerated during the last 12 months, to the point where we are immersed in the worst housing depression since the 1930s. The Federal government is the primary cause and that is because of:

(1) Record deficits as measured by current dollars, percent of the Gross National Product, or percent of personal or total savings -- which is much higher than any other industrial country (Attachments 1 and 2).

(2) Record borrowing by the Federal government for those deficits.

(3) Record seasonal borrowing from annual rates of $60 billion surplus in the second calendar quarter to $200 billion deficit in the fourth and first quarters which

guarantees wide and harmful seasonal fluctuations in interest rates.

(4) Record taking away of personal and other savings from use by housing and industry.

These events:

(5) Have resulted in record real interest rates, double and triple normal levels and much higher during this Congress and Administration than any other (Attachment 3).

(6) Have caused the loss in the value of every American's home up to 25% and caused the loss in the value of the average American's savings and investment in housing by 50%.

(7) Will completely offset the stimulating effects of last year's tax incentives to invest even though that incentive was small compared to last year's tax incentive to consumers and small companies compared to the proportion of past tax relief measures (Attachment 4).

(8) Will limit recovery to about one-half the normal rate (Attachment 5).

(9) Thus, will provide only modest improvement in our nation's standard of living and a limited increase in jobs during the next three years (Attachment 6).

(10) Will continue to cripple the interest-sensitive sectors of the United States economy, such as small business generally, automobiles, farming, exports and housing and the mature regions of the country, such as the North Eastern and North Central States.

(11) Will lead to greater economic concentration and conglomerate tying arrangements which will likely cause

higher housing costs and less home owner choices in financing and products and other services in the future.

In the case of housing, more Americans during the last 40 months have lost the opportunity to satisfy their home owner needs than at any other time in the United States history, including the drop through the years 1929 to 1933. Home sales have fallen 55 percent (from peak to trough) in dramatic and stark contrast to other real sales in the national economy which have dropped only about 3 percent. About 3-1/2 million households have been denied the opportunity to qualify for adequate housing of their own (Attachment 7).

This loss has occurred while the demographic demand for housing is significantly increasing, not decreasing, even before considering replacement demand (Attachment 8). The loss has not only kept would-be home buyers from achieving their dream of home ownership (Attachment 9), but has caused home owners to lose one half of their life savings and investment. This loss occurred because real interest rates for new mortgages (interest rates after adjusting for inflation) have increased from the normal 3 percent level during the post-war period to an average of 6.9 percent during 1981; 11.5 percent so far in 1982; and 8.2 percent forecast for 1983 (Attachment 2).

The higher real interest rates, rising from 3 percent to 8 percent, has caused a loss of 25 percent of the current marketable value of every American's home (Attachment 18), as well as any other long-lived investment, such as commercial, industrial and agricultural real property. When one considers the average equity of people's homes is 60 percent, this means nearly one-half of the equity of all Americans in their homes has been taken away because of high real interest rates caused by bad economic policy (Attachment 10).

Because of the disastrous condition of and disproportionate share of the economic downturn endured by housing, existing programs should be modified (without adding to the deficit in future years) to enable more first-time home buyers to achieve their dream and at the same time help revive housing and the entire economy.

(1) The tax exempt mortgage bond program should be modified to allow the remaining authorization to be used during the next six months (Attachment 11).

(2) The All Savers Certificates should be folded into the temporary tax credit for first-time home owners (Attachment 11).

Housing serves the nation in three ways as shelter for individuals and families and in the case of families to nurture the next generation; as incentives to save and to invest; and as the best way Americans have devised to disperse real decision making. Home ownership permits households to use the home as they wish, and they have a greater incentive to participate in their community, which fundamentally means much more effective democracy.

These objectives, however, are being thwarted by current policy. During the last three years the proportion of the Gross

National Product for housing has declined from 6 percent to 3 percent (Attachment 12). The proportion of loanable funds going to housing has declined from 45 percent average to less than 25 percent (Attachment 13). Housing supply is failing to meet the underlying demand for new housing during 1979-1981, and is forecast to create an even greater shortage if policies do not change.

RECOMMENDATIONS

The NATIONAL ASSOCIATION OF REALTORS® strongly recommends:

(1) Federal spending must be slowed down (Attachment 20) and be reduced in all parts of the federal budget, including defense, entitlement programs, and other programs. Spending this year has overrun the commitments of the President and the Congress by double the rate compared to the last 10 years. REALTORS® have been responsible and recommended many of the cuts which were subsequently proposed by the President and enacted by the Congress last year and called upon other industries to follow our example (Attachment 14).

(2) Tax relief planned for July 1983 and indexing scheduled for 1984 should be deferred.

(3) Tax increases to discourage consumption but not savings and investment should be considered. REALTORS® recommended individual tax relief in the first place should be limited to across-the-board 5 percent each year, instead of 10 percent and the tax relief should be no larger than spending reductions to achieve a balanced budget by 1984 (Attachment 15).

(4) Immediate action to promote housing as the prime hope to lead this nation out of its worst recession. This can be achieved by the REALTORS® three-point program which includes only those tax expenditures already included in the President's deficit estimate and which can be easily shifted (Attachment 11 for greater detail).

a. Administrative and legislative improvements in operations of tax-exempt state and municipal housing bond programs should provide as much as another $10 billion for more mortgages, equivalent to helping 500,000 families realize their dream of homeownership, and

b. A tax credit for first-time homebuyers enabling lowered monthly payments or a down payment and thereby qualifying more families for housing loans. The use of existing funds could allow an additional 250,000 families to own their homes, or

c. A tax credit for the lender who would pass along the savings to the buyer. The use of existing funds could allow an additional 250,000 families to own their own homes.

The three-point program is designed to help the would-be first-time homebuyers who are suffering the most by providing for both new and existing homes.

The program should:

a. Be temporary and not add to the President's current deficit estimates.

b. Help to reduce future-year deficits by sunsetting special assistance and help to generate more jobs and income and, thus, tax receipts.

c. Be limited to first-time homeowners (95 percent of whom cannot now qualify for home ownership).

d. Include new and existing homes. Existing home sales stimulate jobs in the fixing up of homes for sale, the transferring and moving, and the remodeling after sale. Additionally, economic activity equal to one-third of the value of the home is generated in the community and directly creates jobs and purchases from local hardware stores, department stores, appliance stores, etc. These effects are realized very quickly. Also, existing homes sales help thrifts and banks increase the interest earnings on assumptions of existing mortgages. Existing home sales and the jobs they create are located in the established parts of the community and do not require local governments, which are suffering from a shortage of funds, to invest in new schools, sewers and roads in the outer fringe of cities. The beneficial impact of a revitalized resale market is geographically widespread and not confirmed to a relatively few growth areas, particularly the South and West, where most construction is concentrated.

(5) Incentives must be provided for housing for the long run -- such as an IRA-type tax-free savings account for first-time home buyers and tax credits for firms and people who invest

in home mortgages. There is a profound need for government policies supporting housing, to continue after appropriate short-term measures, since the traditional government housing policies are being dismantled through the crippling of savings and loans and through high interest rate policies allowing them to invest less and less in home mortgages.

These recommendations would help return the entire economy to health by helping housing lead the way as it has always done (Attachment 17).

ATTACHMENTS

1. Record Deficits.
2. Central Government Deficits in Major Industrial Countries.
3. Record Real Interest Rates.
4. Tax Incentives Offset by Interest Rise.
5. Recovery Limited.
6. March 1982 Forecast Tables.
7. Losses in Housing.
8. Future Demand for Housing.
9. The American Dream of Homeownership.
10. Homeowners Loss in Value of Homes.
11. Housing Assistance.
12. Housing as Share in Gross National Product (GNP).
13. Housing as Share of Loanable Funds.
14. Letter of January 21, 1981, to Other Associations Suggesting They Find Cuts Too.
15. REALTORS® Recommendations on Size of Tax Relief.
16. Federal Housing Credit Programs.
17. Impact of REALTORS® Recommendations:
    - Fiscal Policy.
    - Mortgage Bonds Modifications.
    - Tax Credit For First-time Home Buyers.
    - Combined Benefits.
18. January 26, 1982 Advertisement.
19. Joint Statement by Members of The Group
20. Spending Overruns Beyond President's Budgets.

ATTACHMENT 1

THE FEDERAL TOTAL DEFICIT AND SAVINGS
($ Billions)

Fiscal Year	Surplus or Deficit(-)			
	Amount	Percent of GNP	Percent of Personal Savings	Percent of Private Savings
1948	12.0	4.9	173.3	35.9
1949	0.6	0.2	5.5	1.4
1950	-3.1	1.2	29.5	7.6
1951	6.1	2.0	51.8	13.9
1952	-1.5	0.4	8.7	2.7
1953	-6.5	1.8	35.9	11.5
1954	-1.2	0.3	6.5	2.1
1955	-3.0	0.8	19.0	4.9
1956	4.1	1.0	21.8	6.1
1957	3.2	0.7	14.2	4.4
1958	-3.0	0.7	13.5	4.1
1959	-12.9	2.7	54.0	16.0
1960	0.3	0.1	1.5	0.4
1961	-3.4	0.7	16.8	4.3
1962	-7.1	1.3	28.8	8.0
1963	-4.8	0.8	22.2	5.3
1964	-6.0	1.0	23.8	6.0
1965	-1.6	0.2	5.2	1.4
1966	-3.8	0.5	10.7	3.0
1967	-8.8	1.1	21.9	6.6
1968	-25.2	3.0	55.2	17.6
1969	3.2	0.4	8.6	2.3
1970	-2.8	0.3	5.8	1.9
1971	-23.0	2.2	37.5	13.5
1972	-23.4	2.1	43.4	12.8
1973	-14.9	1.2	23.3	7.2
1974	-6.1	0.4	7.1	2.6
1975	-53.2	3.6	58.6	21.0
1976	-73.7	4.5	82.0	24.9
1977	-53.6	2.9	74.0	17.3
1978	-59.2	2.8	76.1	17.0
1979	-40.2	1.7	47.6	10.2
1980	-73.8	2.9	76.0	17.4
1981	-78.9	2.8	78.9	17.1
1982 e	-118.3 (131.3) [145.5]	3.8 (4.3) [4.7]	90.3 (100.2) [111.0]	22.9 (25.4) [28.1]
1983 e	-107.2 (137.1) [164.0]	3.1 (4.0) [4.8]	65.4 (83.6) [100.0]	17.5 (22.3) [26.7]
1984 e	-97.2 (144.1) [162.7]	2.6 (3.8) [4.3]	48.5 (71.8) [81.1]	13.6 (20.2) [22.8]

Footnote 1: Figures in parenthesis are based on CBO budget estimates.
Footnote 2: Figures in [ ] are based on REALTORS® budget estimates.

SOURCE: Budget of the United States Government, 1983, Congressional Budget Office, An Analysis of the President's Budgetary Proposals For Fiscal Year 1983
Savings data from the national income accounts and estimates by the NATIONAL ASSOCIATION OF REALTORS®.

ATTACHMENT 2

CENTRAL GOVERNMENT DEFICITS IN MAJOR INDUSTRIAL COUNTRIES

	FY1982 Deficit 1/		
Country	$US billions	% of Personal Savings in 1982 2/	Real Long-Term Interest Rates
United States	118.3 (145.5) 3/	100.2 (111.0)	7-8
Japan	31.8	18.3	2-3
West Germany	23.2	37.8	3.0
France	11.6	19.0	3.0
United Kingdom	15.6	62.5	5

1/ Federal deficit for U.S., general government current account deficits for calendar 1982 for all other countries.

2/ 1982 personal savings figures for all countries other than the U.S. supplied by Wharton Econometric Forecasting Associates.

3/ Figures in parenthesis are REALTOR® estimates.

ATTACHMENT 3

REAL INTEREST RATES IN THE UNITED STATES

Period	Real Long-Term Interest Rates 1/
1950 - 1959 Average	2.04
1960 - 1969 Average	3.41
1970 - 1979 Average	2.23
1980	5.00
1981	6.91
1982 (Forecast)	8.90
1983 (Forecast)	8.20
1984 (Forecast)	8.20

1/ Real long-term interest rates are defined as mortgage rates minus the rate of inflation as measured by the percent change in the GNP deflator.

SOURCE: NATIONAL ASSOCIATION OF REALTORS®.

ATTACHMENT 4.1

THE COMPARATIVE IMPACT OF THE ECONOMIC RECOVERY TAX ACT AND HIGH INTEREST RATES

In 1981, Congress passed the Economic Recovery Tax Act (ERTA) in an effort to stimulate savings and investment. A major feature of the new tax package directed at boosting investment, was the Accelerated Cost Recovery System under which tax lives for investment in equipment, commercial and industrial buildings and rental housing were reduced and certain tax credits enlarged or enhanced. ERTA also contained many other provisions having stimulative effects on savings and investment, including expansion of IRA and Keogh Plan provisions, reduced maximum tax rates on non-service income, and the All Savers Certificate program.

However, by far the largest component of ERTA in terms of revenue cost was the phased across-the-board reduction in individual income tax rates. While these individual rate reductions provide some modest incentive for savings and investment, most of the impact of these tax rate reductions is reflected in higher consumer spending. In all, almost 75 percent of the ERTA tax cuts are directed primarily at increased consumption and only 25 percent at directly stimulating savings and investment, one of the smallest proportions in the post war period.

Exploding Federal deficits and excessively tight credit growth policies have forced both long- and short-term interest rates to record levels, even after adjusting for inflation. Unfortunately, this has and will continue to offset the impact of ERTA in stimulating investment. As a result the share of both non-residential and housing investment in Gross National Product continues to fall, the very opposite of the intent of ERTA (see Table below).

Share of Investment and Consumption in GNP
(Percent)

	Actual			Forecast		
	Average 1970-79	1980	1981	1982	1983	1984
Private Consumption	62.4	63.2	63.5	65.0	65.0	64.7
Non-Residential Investment	10.4	10.7	10.7	10.5	10.5	10.8
Investment in Housing	4.2	3.2	3.0	2.0	3.3	3.6

ATTACHMENT 4.2

The reasons why high interest rates have more than offset the impact of ERTA on investment are demonstrated. The Accelerated Cost Recovery System, the main investment stimulus in the overall package, increased the rate of return (the incentive to invest) in new non-residential structures by about one percentage point--about the same effect as a one percent drop in long-term borrowing costs (see Table below). For rental housing, the increases in return were slightly larger--around 1.8 percentage points--although this still provided very little incentive for new construction because of the uneconomic return prevailing in the industry before ERTA was passed.

Impact of ERTA on Returns[1/] to New Investment
Holding Period, Years

	5	10	15	20
Non-Residential Construction	+1.0	+0.8	+1.3	+2.5
Rental Housing	+1.9	+1.8	+1.6	+1.3

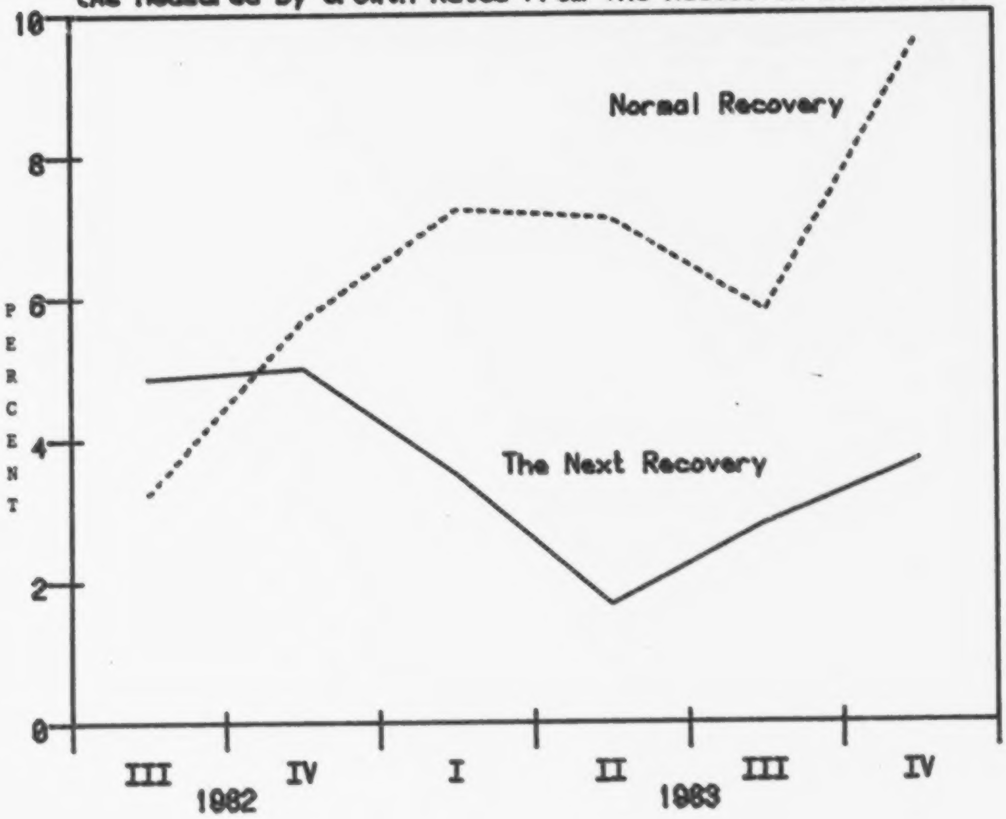
[1/] The effect of a one percentage point increase on after tax returns to investment is approximately equivalent to a one percentage point decrease in interest rates.

Against this, nominal interest rates have risen by almost five percentage points since 1979 and even after adjusting for inflation, are currently more than five percent above normal levels.

This does not imply that the investment incentives in ERTA were inappropriate; on the contrary, they were necessary to stimulate capital formation. However, Congress has the opportunity to enhance the impact of these incentives even more by significantly lowering the Federal deficit, which would allow the Federal Reserve Board to ease its excessively tight credit policies and bring about a sizeable reduction in interest rates.

ATTACHMENT 5

The Next Recovery Will Be Weaker
Than Normal in the Post War Period
(As Measured By Growth Rates From The Recession Low Point)



ATTACHMENT 6.1

Table 1

U.S. ECONOMIC OUTLOOK

MARCH 1982

	QUARTERS							YEARS					
	Actual		Forecast					Actual			Forecast		
	81:3	81:4	82:1	82:2	82:3	82:4	83:1	1979	1980	1981	1982	1983	1984
AGGREGATE ECONOMY													
Gross National Product ($ billions)	2,963	2,995	2,996	3,035	3,120	3,224	3,311	2,414	2,626	2,925	3,096	3,433	3,790
Percent Change	11.4	4.2	0.2	5.3	11.7	14.0	11.5	12.0	8.8	11.4	5.8	10.9	10.4
Percent Change (without inflation)	1.4	-4.7	-3.4	-1.1	4.9	5.0	3.5	3.2	-0.2	2.0	-1.5	3.2	3.2
Consumption	3.1	-2.3	0.2	0.1	5.7	3.8	3.3	2.9	0.5	2.5	0.9	3.1	2.7
Durables	8.0	-10.8	7.5	-3.3	26.5	10.3	4.2	0.2	-7.4	2.6	0.2	5.9	3.9
Nondurables	2.1	-0.7	-1.8	-0.4	1.3	2.0	2.6	2.6	1.1	2.5	0.0	2.0	1.8
Services	2.6	1.9	-0.2	1.9	3.7	3.4	3.6	4.1	2.6	2.6	1.8	3.2	3.1
Residential Investment	-36.1	-28.2	-8.5	19.5	36.7	49.5	19.6	-5.2	-18.6	-6.1	-5.9	19.6	11.8
Nonresidential Investment	7.1	-5.3	-11.6	-6.9	0.7	3.1	4.5	6.5	-3.0	2.4	-4.0	3.5	5.7
Structures	8.4	4.5	-10.0	-11.9	-5.1	-4.4	0.4	8.7	-0.1	5.1	-4.3	-2.1	3.1
Equipment	6.3	-9.2	-12.5	-1.6	5.5	7.7	6.4	5.5	-4.2	1.2	-3.8	6.0	6.8
Exports	-3.4	-13.9	-3.3	1.1	2.8	3.5	4.7	13.2	9.6	-0.9	-3.5	4.2	4.8
Imports	5.3	-0.7	-1.1	1.6	6.4	9.0	7.4	0.0	-0.1	5.5	2.7	6.3	4.6
Government Purchases	-1.6	10.5	-7.5	-2.2	-1.2	-1.0	0.0	1.5	2.9	0.6	-1.3	-0.5	0.5
Consumption (% of GNP)	63.5	63.9	64.8	65.1	65.2	65.0	65.0	62.8	63.2	63.5	65.0	65.0	64.7
Residential Investment (% of GNP)	2.8	2.6	2.6	2.7	2.9	3.2	3.3	4.0	3.2	3.0	2.9	3.1	3.6
Nonresidential Investment (% of GNP)	10.8	10.8	10.6	10.5	10.4	10.4	10.4	11.0	10.7	10.7	10.5	10.5	10.8
Inventory Change ($ billions)	27.5	12.6	-6.9	-11.1	-0.1	6.1	9.9	17.5	-5.9	17.0	-4.0	11.3	18.5
Mfg. Capacity Utilization Rate (%)	79	75	70	71	73	75	76	86	79	78	72	76	77
Auto Sales (millions of units)	9.1	7.6	6.2	7.6	8.8	8.8	9.0	10.6	9.0	8.6	8.4	8.9	9.3
Manufacturing Industrial Production (% change)	0.3	-18.2	-20.9	2.4	17.8	13.0	7.7	4.6	-4.5	2.5	-6.4	7.6	4.8
Common Market	-2.6	4.4	1.8	3.1	4.3	4.3	3.3	4.7	0.2	-2.2	2.2	3.1	2.3
Japan	6.0	11.9	3.1	4.5	2.8	5.6	8.4	8.2	6.8	3.1	5.2	5.2	3.1
Employment (millions)	100.7	100.0	99.3	99.4	99.9	100.5	101.1	98.8	99.3	100.4	99.8	102.3	105.2
Unemployment Rate (%)	7.4	8.4	8.8	9.2	9.2	9.1	9.0	5.9	7.2	7.6	9.1	8.7	8.0
Disposable Income per Household (average)	26,349	26,870	27,153	27,559	28,523	29,217	29,876	21,565	23,748	26,040	28,113	30,923	33,656
Percent Change -- Year Ago (w/o inflation)	1.5	1.1	0.3	0.3	1.8	2.4	3.2	2.2	-0.1	1.2	1.2	3.0	2.1
Total Taxes per Household (average)	13,651	13,503	13,350	13,515	13,480	13,782	13,986	11,106	12,057	13,469	13,536	14,122	15,058
Percent Change -- Year Ago	13.0	6.4	0.1	1.0	-1.2	2.1	4.7	10.5	8.6	11.7	0.5	4.3	6.6
Percent of Disposable Income	51.8	50.2	49.2	49.0	47.3	47.2	46.8	51.5	50.8	51.7	48.2	45.7	44.7
Household Debt as Percent of Disposable Income	77.6	77.1	77.3	77.1	75.5	75.2	75.2	80.2	79.4	[illegible]	76.2	[illegible]	[illegible]
Consumer Price Inflation (CPI)	11.8	7.8	4.3	6.0	7.1	8.2	9.1	11.3	13.5	10.3	7.0	8.3	8.5
Gross National Product Inflation (GNP Deflator)	9.9	9.3	5.8	6.5	6.5	8.5	7.8	8.5	9.0	9.2	7.6	7.5	7.0
Personal Consumption Inflation	9.1	7.8	5.5	5.8	6.1	7.1	7.4	8.9	10.2	8.3	6.7	6.8	6.6
Residential Construction Inflation	7.1	6.4	8.9	6.8	8.7	10.2	10.3	12.8	9.4	6.9	7.7	9.6	8.9
Nonresidential Construction Inflation	8.6	10.7	9.1	8.1	8.9	10.3	10.9	12.6	13.4	9.5	9.5	10.0	8.8
Producers Price Inflation (WPI)	4.7	0.6	2.6	4.2	7.2	9.4	9.3	12.5	14.1	9.1	4.2	8.2	8.5
Compensation per Manhour (% change)	9.6	6.5	9.0	7.8	7.8	8.4	8.9	9.7	9.9	10.0	8.2	8.4	8.9
Productivity (% change)	-2.0	-7.6	-3.8	0.4	4.5	3.1	2.5	-0.7	-0.3	0.8	-1.7	2.4	1.6
Unit Labor Cost (% change)	11.3	15.0	13.3	7.4	3.2	5.1	6.2	10.4	10.3	9.1	10.1	5.8	7.1
Unit Capital Cost (% change)	9.5	8.8	8.3	8.0	7.7	7.5	7.3	11.3	11.3	9.8	7.9	7.4	9.1
Before Tax Corporate Profits ($ billions)(1)	263	227	206	203	218	235	245	255	238	230	215	253	284
Corporate Tax Liability	70	67	58	57	63	69	70	88	82	77	61	73	79
"Windfall Profits" Tax Receipts	39	26	26	26	25	26	24	0	13	29	25	23	26
Inventory Valuation Adjustment	-23	-22	-10	-15	-17	-21	-23	-43	-44	-28	-18	-24	-36
Capital Consumption Adjustment	-13	-13	-10	-7	-4	-2	2	-16	-17	-14	-8	3	5
After Tax Profits	156	134	122	122	131	140	151	168	163	153	129	157	179
Profits from Current Production (with IVA, CCA)	118	99	103	100	109	118	128	109	100	112	107	136	148
Adjusted for Inflation (81:3 base)	118	97	99	95	102	108	115	131	111	113	101	119	121
Percent Change - Year Ago	8.3	-6.8	-17.5	-18.9	-13.3	11.2	16.5	-1.6	-15.7	1.8	-10.6	17.8	1.7
Per Unit of Output (% of GNP)	4.0	3.3	3.4	3.3	3.5	3.7	3.9	4.5	3.8	3.8	3.5	4.0	3.9
Effective Corporate Tax Rate (%)(1)	41	41	37	37	38	38	36	65	65	61	38	36	36
Federal Tax Receipts (Unified basis)	627	589	516	720	585	567	571	481	533	623	599	648	710
Federal Expenditures (Unified basis)	661	782	709	722	706	770	788	509	601	695	727	799	853
Surplus or Deficit (Unified basis)	-34	-193	-193	-2	-122	-203	-217	-28	-68	-73	-128	-151	-144
% of GNP	-1.2	-6.4	-6.2	-0.1	-3.9	-6.3	-6.5	-1.2	-2.6	-2.5	-4.1	-4.4	-3.8

(1) Adjusted to include impact of windfall profits tax on domestic crude oil production.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, Kenneth Marin, and Glenn Crellin.

ATTACHMENT 6.2

Table 2

REAL ESTATE AND FINANCIAL MARKETS

MARCH 1982

	QUARTERS							YEARS					
	Actual		Forecast					Actual			Forecast		
	81:3	81:4	82:1	82:2	82:3	82:4	83:1	1979	1980	1981	1982	1983	1984
REAL ESTATE MARKETS													
Existing Single-Family Home Sales (thousands)	2,233	1,983	1,904	2,137	3,480	2,887	2,973	3,701	2,881	2,351	2,361	3,183	3,673
Percent Change - Year Ago	-25.7	-34.6	-23.0	-18.8	10.3	47.5	56.1	-4.2	-22.2	-18.4	0.4	34.9	15.4
Dollar Volume (billions)	170.7	140.2	133.0	173.1	207.3	233.3	240.4	227.6	200.7	164.1	191.9	280.0	300.4
Existing Home Prices - Median ($000's)	67.6	66.2	67.2	68.6	71.2	71.5	73.2	55.7	62.2	66.4	70.1	76.7	85.9
Percent Change - Year Ago	4.9	4.5	4.5	4.8	6.9	8.1	8.9	14.4	11.7	6.8	6.1	9.4	12.0
Monthly Mortgage Payment (Pri., 80%, 30 yr.)	786	795	788	758	757	780	830	433	580	742	760	813	936
Percent of Household Income	30	30	29	28	27	27	28	20	25	28	28	28	29
New Single-Family Home Sales (thousands)	350	307	376	464	535	512	500	709	530	436	471	589	615
Percent Change - Year Ago	-40.2	-35.6	-30.0	3.9	40.9	20.6	33.2	-13.7	-26.5	-19.5	10.0	25.1	4.5
New Home Prices - Median ($000's)	69.8	70.0	71.2	72.5	74.2	76.3	78.5	62.9	64.5	68.8	73.5	81.7	90.4
Percent Change - Year Ago	6.2	3.2	3.9	3.0	6.3	9.0	10.2	12.9	2.5	6.7	6.6	11.1	10.5
New Home Prices--Mean ($000's, Quality Adjusted)	88.9	88.7	90.2	92.6	93.4	94.5	98.4	71.4	78.5	85.3	92.7	101.2	110.2
Percent Change - Year Ago	7.4	6.0	6.3	6.6	6.7	9.0	9.1	14.0	10.1	8.6	8.6	9.2	8.9
New Mortgage Commitments ($ billions)	47.9	42.5	43.6	61.9	87.3	86.2	80.9	129.0	87.1	59.5	70.2	80.1	112.9
Percent Change - Year Ago	-38.5	-33.6	-41.6	-10.8	82.1	102.0	77.3	-8.8	-32.5	-31.7	18.0	-1.7	63.3
Mortgage Debt Outstanding ($ billions)	1,525	1,550	1,580	1,602	1,640	1,680	1,720	1,290	1,408	1,512	1,642	1,780	1,940
Homeowners' Equity ($ billions)	2,946	2,980	3,030	3,085	3,134	3,190	3,250	2,611	2,730	2,913	3,090	3,430	3,880
Housing Inventory (millions)	84.6	84.7	84.8	84.8	84.9	85.1	85.3	82.8	83.6	84.5	84.9	85.6	86.4
Private Housing Starts (thousands)	961	871	899	986	1,189	1,263	1,316	1,745	1,292	1,085	1,160	1,374	1,629
Single-Family	644	540	602	650	822	974	900	1,194	852	705	763	944	1,178
Multi-Family	317	331	297	336	367	289	406	551	440	379	397	430	451
Subsidized	90	108	136	142	136	113	75	173	173	106	138	32	10
Mobile Home Shipments (thousands)	240	207	192	195	200	210	225	276	283	240	199	221	236
Rental Vacancy Rate (%)	5.0	5.0	5.0	4.9	4.8	4.8	4.7	5.4	5.4	5.0	4.9	4.7	4.5
Unsold New Homes (% of sales)	88.9	75.2	70.3	70.2	73.5	67.4	65.1	59.5	70.2	76.1	74.6	66.5	70.8
Office Vacancy Rate (%)<1>	4.4	4.8	3.0	3.0	4.9	4.9	4.8	4.4	3.7	4.3	3.0	4.6	4.2
Industrial Vacancy Rate (%)<1>	3.7	3.8	4.0	4.1	4.2	4.4	4.3	3.0	3.3	3.7	4.2	4.3	3.9
New Commercial Building Construction (% Ch Value)	12.5	0.5	-3.4	0.2	-1.7	3.6	14.0	33.0	21.7	11.1	0.3	10.3	14.9
New Industrial Building Construction (% Ch Value)	60.3	3.8	-37.0	-30.2	13.6	17.3	20.0	37.2	-6.7	20.3	-3.1	31.6	35.4
FINANCIAL MARKETS													
Personal Savings Rate (%)	5.2	6.1	5.9	6.2	7.0	7.0	6.9	5.3	5.6	5.3	6.3	7.4	8.0
Money Supply (M1b) (% change)	-0.2	5.9	9.0	1.4	6.4	3.4	4.3	7.8	6.2	6.7	5.2	4.2	4.1
Money Supply (M2) (% change)	8.6	9.1	10.0	5.9	6.0	9.6	8.7	8.9	8.7	9.1	9.0	8.8	11.3
Total Time and Savings Deposits (% change)	6.7	6.2	7.1	9.2	8.7	9.2	9.2	8.6	7.5	8.7	7.6	8.9	7.6
Selected Interest Rates (Percent)													
New Home Mortgage Commitment Rate	17.39	17.99	17.21	16.10	15.32	16.23	16.40	11.27	14.00	16.71	16.30	16.16	16.22
'People-to-People' Mortgage Rate	13.00	12.80	12.50	12.10	12.30	12.90	12.70	[illegible]	11.25	13.13	12.35	11.90	11.70
Corporate Bond Rate (AAA)	14.32	14.62	14.81	14.43	13.96	14.12	14.26	9.63	11.94	14.17	14.32	14.17	14.23
Government Bond Rate	15.64	14.11	14.30	12.45	12.30	13.11	13.56	9.42	11.31	14.34	13.06	13.37	13.13
Federal Funds Rate	17.58	13.30	14.70	12.32	12.76	14.23	15.18	11.19	13.36	16.38	13.53	13.87	14.76
3 Month Treasury Bills	15.05	11.75	13.40	11.20	11.67	12.79	13.67	10.07	11.43	14.03	12.28	14.02	13.32
1 Year Treasury Bills	16.32	13.35	14.77	12.30	12.56	13.31	13.79	10.67	12.05	14.78	13.20	14.07	13.46
Commercial Paper Rate	16.77	13.04	14.06	11.00	12.42	14.21	15.12	10.97	12.66	15.33	13.14	[illegible]	14.43
Rate on Money Market Fund Shares	17.21	13.31	14.42	12.13	12.67	14.30	15.43	11.12	12.80	15.60	13.43	14.8	14.71
Prime Rate	20.32	17.06	16.70	14.93	15.25	16.02	17.18	12.67	15.27	18.87	15.95	17.19	15.78

<1> Historical data courtesy of Coldwell Banker.

Source: Model developed by the NATIONAL ASSOCIATION OF REALTORS, and Data Resources, Inc.
Assumptions and simulations by Dr. Jack Carlson, Hugh Graham, Kenneth Harris, and Shaun Crellin.

ATTACHMENT 7

COMPONENTS OF LOST GNP ATTRIBUTABLE TO THE DECLINE IN REAL ESTATE ACTIVITY

(Billion)

Expenditure Category	1979	1980	1981	Aggregate 3-Year Total
Single family sales & construction	$3.7	$38.5	$58.8	$101.0
Single family construction	1.1	24.0	33.5	58.6
Expenditures before resales	.2	.9	1.6	2.7
Expenditures at the time of sale	2.0	10.5	17.9	30.4
Expenditures after sale	.4	2.6	4.2	7.2
Lender's income net of cost of funds	.1	.5	1.5	2.1
Mortgage insurers' income	.	.	.1	.1
Multifamily construction	5.6	8.9	11.4	25.9
Manufactured Housing production	.2	1.4	1.5	3.1
Commercial and industrial construction	1.5	9.5	12.5	23.5
All other private construction	1.2	2.5	8.2	11.9
Multiplier effects	6.1	30.4	46.2	82.7
Total	$18.4	$91.2	$138.6	$248.2

. Less than $.05 Billion.

ATTACHMENT 8.1

UNITED STATES
LONG TERM HOUSING OUTLOOK 1980 - 1990
Average Annual Growth Rates in the Demographic Demand for Housing
By Tenure And By Structure Type
(excludes replacement demand)
(percent)

	10 YEAR INTERVALS				5 YEAR INTERVALS			
	ACTUAL			FORECAST	ACTUAL		FORECAST	
	Previous Decades			Next Decade	Previous 5 Years		Next 5 Years	
Structure Type	1950 to 1960	1960 to 1970	1970 to 1980	1980 to 1990	1970 to 1975	1975 to 1980	1980 to 1985	1985 to 1990
ALL OCCUPIED UNITS	2.2	2.8	2.4	1.7	2.7	2.2	1.7	1.6
OWNER OCCUPIED	3.4	2.0	3.2	2.0	3.3	3.2	2.3	1.6
Single Unit	3.7	1.7	3.1	1.9	3.1	3.2	2.2	1.6
Multi Unit	-1.7	2.0	2.1	3.0	0.7	3.4	3.7	2.4
Mobile Homes	10.5	10.0	6.6	1.8	10.0	3.4	1.9	1.7
RENTER OCCUPIED	0.5	1.5	0.9	1.0	1.7	0.1	0.5	1.4
Single Unit	1.3	-1.3	-1.0	1.3	-0.2	-1.7	1.1	1.4
Multi Unit	-0.2	3.5	1.7	0.8	2.6	0.9	0.2	1.4
Mobile Homes	3.3	13.6	6.5	1.3	10.1	2.9	1.1	1.6

1/ This is a forecast of the potential demographic demand for housing and is based on Series II state population projections by the Bureau of the Census, and unpublished data from the Annual Housing Survey and the Current Population Survey.

2/ The figure for 1980 was estimated based on national data from the Bureau of the Census, "Household and Family Characteristics: March 1980", Series P-20, No. 366, Table #24, September 1981; and "Households and Families, By Type: March 1981 (Advance Report)", Series P-20, No. 367, Table #4, October 1981.

SOURCE: NATIONAL ASSOCIATION OF REALTORS. Actual data from the 1950, 1960, and 1970 Censuses of Housing; 1975 Annual Housing Survey; and the 1980 Current Population Survey.

ATTACHMENT 8.2

LONG TERM HOUSING OUTLOOK 1980 - 2000
Average Annual Growth Rate In The Demographic Demand For Housing
For All Occupied Housing Units, By Region And By State
(excludes replacement demand) (percent)

	10 YEAR INTERVAL					5 YEAR INTERVAL			
	ACTUAL			FORECAST		FORECAST			
	1950 to 1960	1960 to 1970	1970 to 1980	1980 to 1990	1990 to 2000	1980 to 1985	1985 to 1990	1990 to 1995	1995 to 2000
UNITED STATES	2.2	1.8	2.4	1.7	1.1	1.7	1.6	1.2	1.0
NORTH EAST	1.9	1.4	1.4	1.1	.7	1.1	1.0	.7	.6
Connecticut	2.8	2.2	1.6	1.1	.6	1.2	1.0	.7	.5
Maine	1.0	.8	2.4	2.1	1.6	2.2	2.1	1.6	1.5
Massachusetts	1.6	1.4	1.5	1.4	.9	1.5	1.4	1.0	.8
New Hampshire	1.5	2.3	2.9	2.2	1.6	2.3	2.1	1.7	1.4
New Jersey	2.8	2.1	1.6	1.2	.8	1.3	1.2	.7	.9
New York	2.0	1.2	1.2	.8	.5	.8	.8	.6	.5
Pennsylvania	1.4	1.0	1.2	.9	.5	1.0	.9	.6	.4
Rhode Island	1.3	1.3	1.2	1.3	.9	1.4	1.3	1.0	.9
Vermont	.7	1.8	2.3	1.8	1.2	1.8	1.7	1.3	1.1
NORTH CENTRAL	1.7	1.3	2.0	1.2	.7	1.2	1.1	.8	.6
Illinois	1.8	1.3	1.6	.9	.5	1.0	.9	.6	.5
Indiana	1.7	1.5	2.0	1.2	.7	1.2	1.1	.7	.6
Iowa	.8	.6	2.0	1.2	.8	1.3	1.1	.9	.7
Kansas	1.4	.8	2.0	1.2	.8	1.3	1.2	.8	.7
Michigan	2.3	1.7	2.3	1.3	.7	1.4	1.2	.8	.6
Minnesota	1.6	1.5	2.5	1.5	.9	1.6	1.4	1.0	.8
Missouri	1.3	1.1	1.8	1.2	.8	1.3	1.2	.8	.8
Nebraska	1.0	.9	2.3	1.6	1.0	1.6	1.5	1.1	1.0
North Dakota	.7	.5	2.9	1.4	.9	1.5	1.3	.9	.9
Ohio	2.1	1.4	1.8	.9	.4	1.0	.8	.5	.3
South Dakota	.6	.3	2.6	1.3	.8	1.4	1.2	.8	.8
Wisconsin	1.7	1.5	2.8	1.7	1.1	1.8	1.6	1.2	.9
SOUTH	2.1	2.2	3.1	2.2	1.6	2.3	2.1	1.6	1.5
Alabama	1.2	1.6	2.6	1.8	1.2	1.9	1.7	1.3	1.2
Arkansas	-.0	1.6	2.9	1.9	1.4	2.0	1.9	1.4	1.3
Delaware	3.6	2.5	2.6	1.6	1.0	1.7	1.5	1.1	.9
D.C.	1.2	.4	-.7	.1	-.0	.1	.2	-.1	.0
Florida	6.6	4.0	5.1	3.3	2.2	3.6	3.0	2.3	2.0
Georgia	1.9	2.5	3.0	2.3	1.7	2.3	2.2	1.8	1.6
Kentucky	.9	1.4	2.6	1.9	1.3	1.9	1.8	1.4	1.3
Louisiana	2.1	1.7	2.4	1.6	1.1	1.7	1.6	1.2	1.0
Maryland	3.0	3.1	2.8	2.0	1.4	2.0	1.9	1.5	1.3
Mississippi	.2	1.1	2.6	1.7	1.2	1.7	1.6	1.3	1.2
North Carolina	1.9	2.3	3.2	2.1	1.5	2.2	2.1	1.6	1.4
Oklahoma	1.0	1.5	2.2	1.8	1.3	1.8	1.7	1.3	1.2
South Carolina	1.6	2.0	3.6	2.4	1.7	2.5	2.3	1.8	1.6
Tennessee	1.4	1.9	2.8	1.8	1.3	1.9	1.7	1.3	1.2
Texas	2.4	2.1	3.0	2.3	1.6	2.3	2.2	1.7	1.6
Virginia	2.4	2.6	3.2	2.1	1.5	2.2	2.1	1.6	1.4
West Virginia	.1	.5	2.4	1.5	1.0	1.6	1.4	1.1	1.0
WEST	3.7	2.6	3.2	2.0	1.3	2.1	1.9	1.4	1.2
Alaska	N/A	3.3	5.2	2.2	1.5	2.4	2.1	1.6	1.4
Arizona	5.7	3.9	5.9	3.3	2.1	3.6	3.0	2.3	1.9
California	4.1	2.8	2.7	1.8	1.1	1.9	1.7	1.2	1.1
Colorado	3.1	2.7	4.2	2.8	1.8	3.0	2.6	1.9	1.7
Hawaii	N/A	2.9	5.3	2.2	1.5	2.4	2.1	1.6	1.3
Idaho	1.4	1.2	4.3	2.6	1.8	2.8	2.4	1.9	1.7
Montana	1.4	.7	3.4	2.1	1.4	2.3	1.9	1.4	1.3
Nevada	6.2	5.7	4.7	2.7	1.8	2.9	2.5	1.9	1.6
New Mexico	3.6	1.4	4.3	2.6	1.7	2.8	2.4	1.8	1.6
Oregon	1.5	2.2	3.4	2.0	1.4	2.2	1.9	1.4	1.3
Utah	2.5	2.1	3.9	2.5	1.8	2.7	2.4	1.9	1.8
Washington	2.0	2.1	2.4	1.3	.8	1.3	1.2	.9	.7
Wyoming	1.7	.5	4.1	2.5	1.6	2.7	2.3	1.7	1.5

N/A = Not Available

1/ This is a forecast of potential demographic demand for housing and is based on Series II State population projections by the Bureau of the Census, and unpublished data from the Annual Housing Survey and the Current Population Survey.

2/ A housing unit is occupied if a person or group of persons is living in it at the time of the survey or if the occupants are only temporarily absent; for example, on vacation. A housing unit is "owner occupied" if the owner or co-owner lives in the unit, even if it is mortgaged or not fully paid for. All other occupied units are "renter occupied."

SOURCE: NATIONAL ASSOCIATION OF REALTORS®. Actual data from the 1950, 1960, and 1970 Censuses of Housing; 1975 Annual Housing Survey; and the 1980 Current Population Survey.

ATTACHMENT 8.3

UNITED STATES
LONG TERM HOUSING OUTLOOK 1980 - 1990

Increase in the Demographic Demand for Housing
By Tenure And By Structure Type
(excludes replacement demand)
(millions)

	10 YEAR INTERVALS				5 YEAR INTERVALS			
	ACTUAL			FORECAST	ACTUAL		FORECAST	
	Previous Decades			Next Decade	Previous 5 Years		Next 5 Years	
Structure Type	1950 to 1960	1960 to 1970	1970 to 1980	1980 to 1990	1970 to 1975	1975 to 1980	1980 to 1985	1985 to 1990
ALL OCCUPIED UNITS	10.2	10.4	17.2	14.4	9.1	8.2	7.2	7.2
OWNER OCCUPIED	9.2	7.1	15.0	11.8	7.0	8.0	6.5	5.2
Single Unit	9.2	5.5	12.8	10.0	5.8	7.0	5.6	4.4
Multi Unit	-0.4	0.5	0.6	1.1	0.1	0.5	0.6	0.5
Mobile Homes	0.4	1.1	1.6	0.7	1.1	0.5	0.3	0.3
RENTER OCCUPIED	1.0	3.3	2.3	2.6	2.1	0.2	0.7	2.0
Single Unit	1.1	-1.2	-0.8	1.0	-0.1	-0.7	0.4	0.6
Multi Unit	-0.2	4.3	2.8	1.5	2.0	0.8	0.2	1.3
Mobile Homes	na	0.2	0.3	0.1	0.2	0.1	na	0.1

na = less than 100,000

1/ This is a forecast of the potential demographic demand for housing and is based on Series II state population projections by the Bureau of the Census, and unpublished data from the Annual Housing Survey and the Current Population Survey.

2/ The figure for 1980 was estimated based on national data from the Bureau of the Census, "Household and Family Characteristics: March 1980", Series P-20, No. 366, Table #24, September 1981; and "Households and Families, By Type: March 1981 (Advance Report)", Series P-20, No. 367, Table #4, October 1981.

SOURCE: NATIONAL ASSOCIATION OF REALTORS. Actual data from the 1950, 1960, and 1970 Censuses of Housing; 1975 Annual Housing Survey; and the 1980 Current Population Survey.

ATTACHMENT 8.4

LONG TERM HOUSING OUTLOOK 1980 - 2000
Increase In The Demographic Demand For Housing
For All Occupied Housing Units, By Region And By State
(excludes replacement demand) (thousands)

	10 YEAR INTERVAL					5 YEAR INTERVAL			
	ACTUAL			FORECAST		FORECAST			
	1950 to 1960	1960 to 1970	1970 to 1980	1980 to 1990	1990 to 2000	1980 to 1985	1985 to 1990	1990 to 1995	1995 to 2000
UNITED STATES	10,198	10,422	17,242	14,418	11,129	7,229	7,189	5,778	5,351
NORTH EAST	2,295	1,961	2,282	1,979	1,346	1,009	970	710	636
Connecticut	184	178	164	127	70	67	60	40	30
Maine	27	22	79	90	79	44	46	39	40
Massachusetts	229	226	288	316	229	160	156	125	104
New Hampshire	26	44	73	75	61	36	39	31	30
New Jersey	433	411	375	339	247	169	170	109	138
New York	923	665	761	550	377	277	273	201	176
Pennsylvania	435	356	468	407	220	217	190	129	91
Rhode Island	31	35	39	48	37	23	25	18	19
Vermont	9	22	33	31	26	16	15	13	13
NORTH CENTRAL	2,407	2,157	3,900	2,678	1,723	1,370	1,308	930	793
Illinois	503	417	610	401	248	201	200	131	117
Indiana	218	223	346	235	152	121	114	81	71
Iowa	62	54	200	137	101	72	65	55	46
Kansas	85	55	156	114	78	59	55	39	39
Michigan	454	409	662	447	280	231	216	155	125
Minnesota	149	160	328	242	160	123	119	86	74
Missouri	163	160	294	235	166	117	118	85	81
Nebraska	39	41	122	100	78	51	49	39	39
North Dakota	12	6	61	37	26	20	17	14	12
Ohio	539	436	634	368	183	195	173	108	75
South Dakota	14	6	56	35	25	20	15	14	11
Wisconsin	179	182	431	323	228	163	160	122	106
SOUTH	2,869	3,755	6,899	6,347	5,406	3,135	3,212	2,756	2,650
Alabama	97	149	301	258	208	129	129	107	101
Arkansas	-2	90	205	174	145	87	87	73	72
Delaware	37	36	50	34	26	18	16	16	10
D.C.	26	12	-20	1	2	0	1	1	1
Florida	729	734	1,481	1,444	1,245	726	718	638	607
Georgia	181	299	461	460	413	224	236	208	205
Kentucky	72	132	291	258	217	127	131	111	106
Louisiana	170	158	281	236	181	116	120	93	88
Maryland	223	311	379	337	280	165	172	146	134
Mississippi	13	70	182	149	125	74	75	64	61
North Carolina	211	304	555	485	412	240	245	212	200
Oklahoma	73	114	207	202	171	101	101	86	85
South Carolina	93	130	306	279	247	136	143	124	123
Tennessee	133	210	379	313	256	156	157	132	124
Texas	588	656	1,179	1,158	1,024	566	592	512	512
Virginia	228	319	507	452	371	223	229	191	180
West Virginia	3	25	146	110	89	56	54	45	44
WEST	2,625	2,549	4,162	3,413	2,654	1,716	1,697	1,382	1,272
Alaska	59	21	52	32	28	15	17	14	14
Arizona	157	172	416	369	307	186	183	158	149
California	1,649	1,588	1,990	1,658	1,234	833	825	650	584
Colorado	140	160	351	327	267	164	163	138	129
Hawaii	153	51	139	83	67	42	41	35	32
Idaho	25	25	115	96	82	49	47	41	41
Montana	26	14	86	69	55	34	35	28	27
Nevada	41	67	96	76	62	38	38	33	29
New Mexico	71	39	153	130	103	63	67	52	51
Oregon	80	134	271	216	170	110	106	88	82
Utah	54	56	140	125	114	64	61	55	59
Washington	159	211	301	187	131	95	92	68	63
Wyoming	16	6	51	42	35	21	21	17	18

na = not available

1/ This is a forecast of potential demographic demand for housing and is based on Series II State population projections by the Bureau of the Census, and unpublished data from the Annual Housing Survey and the Current Population Survey.

2/ A housing unit is occupied if a person or group of persons is living in it at the time of the survey or if the occupants are only temporarily absent; for example, on vacation. A housing unit is "owner occupied" if the owner or co-owner lives in the unit, even if it is mortgaged or not fully paid for. All other occupied units are "renter occupied".

SOURCE: NATIONAL ASSOCIATION OF REALTORS®. Actual data from the Bureau of the Census, 1950, 1960, and 1970 Censuses of Housing: 1975 Annual Housing Survey; and the 1980 Current Population Survey. - - -

ATTACHMENT 9.1

THE AMERICAN DREAM OF HOMEOWNERSHIP

Policy Statement Adopted by the
Board of Directors
February 8, 1982

The NATIONAL ASSOCIATION OF REALTORS® is dedicated to providing and protecting the opportunity for all Americans to own their own home. Homeownership extends beyond decent and satisfactory shelter and creates the incentive to save and invest. Homeownership allows each individual to own a piece of America. The home encourages more active participation in the community which is fundamental to our democratic system.

But homeowners and homebuyers have suffered disproportionately during recent times. Record high interest rates have kept many Americans from selling homes, depressed the value of all homes and have denied many thousands of would-be homebuyers from realizing the American dream.

Workers are being discouraged from selling their current home to buy a home nearer a better job. Consequently, the nation's businesses are suffering lower productivity and workers are receiving lower wages or experiencing unemployment.

Existing and new home sales during the past three years have declined by more than 50 percent. The cause can be traced to bad government policies which have driven interest rates to record high levels after adjusting for inflation.

In support of homeownership and democracy, we petition the Federal government to bring mortgage interest rates down by:

- reducing the federal deficit and federal borrowing to allow lendable funds to be used for housing;
- allowing the money supply to grow two percentage points faster than planned by the Federal Reserve Board and stabilizing growth to eliminate unnecessary and harmful fluctuation of interest rates;
- providing more adequate incentives for investment in homeownership to match more generous incentives provided for other investment;
- allowing Individual Housing Accounts for first time homebuyers (pattered after Individual Retirement Accounts);
- providing a housing mortgage tax credit for investors to stimulate an increasingly larger proportion of home mortgages; and

ATTACHMENT 9.2

- providing a tax credit as assistance to those who wish to own a home. The tax incentive could take a variety of forms, should be temporary, and should be structured to qualify the largest possible number of first time homebuyers for mortgage loans.

Short-term programs should be designed to merge smoothly into long-term programs. Any type of housing assistance should be matched with offsetting spending reductions or tax programs. These programs should not add to the Federal deficits, but reduce the deficit in 1984 and beyond, which has been the primary cause of high real interest rates.

Every American should have the opportunity for homeownership. Every American should have the opportunity for adequate shelter and the opportunity to save and invest in their own home. Just as important, every person should have the opportunity to participate in our democratic process by owning a piece of their country.

We recognize that government policy has caused high interest rates which threaten the viability of savings and loans and community banks, which have traditionally provided mortgages for housing. We recognize further that economic policies have not adequately encouraged savings and, in fact, have encouraged consumption.

The NATIONAL ASSOCIATION OF REALTORS® supports measures to encourage increased savings and the development of programs to insure a greater flow of funds into mortgages, including more mortgage lending by thrifts and community banks. The Adjustable Rate Mortgage, with homeowner safeguards against abrupt changes in monthly payments, will lower the risk of mortgage lending for those affected by the current housing crisis. We expect the fixed payment and fixed rate mortgage (fully amortized) will continue to be relied upon, particularly as stabilized interest rate conditions return. In the transition we would support assistance for the thrifts that can be viable in the long run with limited federal help.

The NATIONAL ASSOCIATION OF REALTORS®, in pursuit of its goal of affordable housing opportunities for the nation as a whole, is seriously concerned with recent public actions and proposals.

- We think it unwise to tolerate huge and growing federal deficits and federal borrowing that takes away a large proportion of people's savings and reduces investment in housing.

- We think it unwise to slow money and credit growth so severely that it continues the recession and undermines homeownership.

- We think it unwise to cause interest rates to fluctuate so widely that it raises unnecessary fears about the future.

- We think it is unwise to permit savings and loans, which were created to serve homeownership, to invest every deposit dollar outside home mortgages.

ATTACHMENT 9.3

- We think it is unwise to encourage economic concentration and less competition by promoting vertical, horizontal and conglomerate mergers of financial entities which transfer control of savings and investment from communities to national and international financial and other organizations.

- We believe it unwise to encourage or permit savings and loan and banks to lend to their subsidiaries for businesses outside of banking, thereby undermining competition in other industries and compromising fiduciary responsibilities to depositors.

We urge all Americans and our government to keep alive the American dream of homeownership.

ATTACHMENT 10

HOMEOWNERS LOSS IN VALUE OF HOUSING

Value to Seller		Buyer's Monthly Principal and Interest Payment
$72,100	Normal Conditions Mortgage rate 10% (3% real)	$506
$66,800	Current Market with "people-to-people" financing 13% (6% real)	$591
$55,400	Current Market with new mortgage interest rates provided by financial institutions 17% (10% real)	$631

Everybody loses in the current market. Sellers are forced to sell at prices which have not kept up with inflation and sacrifice to provide "people-to-people" financing. Effective sales price is thus $16,700 below that received in normal circumstances.

The seller's loss does not turn out to be the purchaser's gain, however. A purchaser of a home for $55,400 at today's interest rates would have principal and interest payments of $631 -- $125 more than for the purchase of the home for $72,100 at 10 percent interest. The "people-to-people" financing price and interest rate minimize both the seller's loss and the buyer's payment jump.

ATTACHMENT 11

NATIONAL ASSOCIATION OF REALTORS HOUSING PROPOSALS

America's Housing Industry is in a Depression:

- The current slump in home sales is five times worse than at any time in the post-war period...
- Economic activity associated with housing construction and sales which has been lost in the last three years amounts to almost $200 billion...
- Over two million housing and related jobs have been lost since 1980...
- Only five percent of non-homeowners can qualify for an 80 percent mortgage on a median-priced home, and lenders have effectively shut the window on mortgage lending activity.

The NATIONAL ASSOCIATION OF REALTORS® recommends:

- Provide administrative and legislative changes to the Mortgage Revenue Bond program to increase the number of bonds that can be issued and make mortgages provided by the bonds more widely available. 500,000 families could achieve homeownership under this program within one year of the date these changes are adopted.
- Allow first-time homebuyers a credit against Federal income taxes of up to $5,400 on the purchase of a home between March 1 and December 31, 1982. The result would be that more than 250,000 first-time homebuyers, who would not otherwise have been able to afford a home, could purchase a home in 1982.
- Allow mortgage lenders a credit against federal income taxes of up to $5,400 if they make home mortgage loans during the period March-December, 1982. In order to qualify for the credit, lenders would be required to use the amount of the credit to decrease the effective rate of interest on the mortgage by three percentage points for a three-year period.

Where's the Money Coming From?

Much, if not all, of the cost of such a program could be recouped through a curtailment of the existing All Savers program as of March 31, 1982, instead of its current ending date of December 31, 1982.

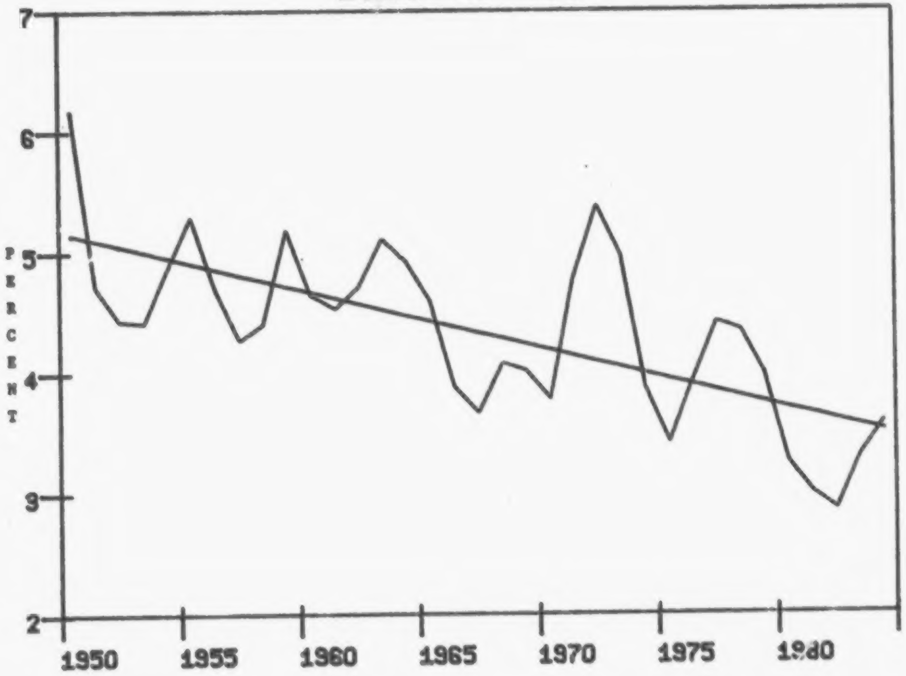
Revenue loss estimates for the All Savers program, at the time of enactment, were $3.3 billion. As of this date, some $700 million of that amount has been "consumed" by the issuance of All Savers Certificates, leaving $2.6 billion unused by the program. Current estimates are that the program will not be significantly expanded between now and March 31.

POSSIBLE DOLLAR SAVINGS TO HOMEBUYER ON MONTHLY MORTGAGE PAYMENT FOR PRINCIPAL AND INTEREST IF TAX CREDIT IS USED TO "BUY DOWN" INTEREST RATE

MORTGAGE INTEREST RATE WITHOUT CREDIT	MORTGAGE INTEREST RATE WITH CREDIT	MONTHLY PAYMENT FOR PRINCIPAL AND INTEREST WITHOUT CREDIT	MONTHLY PAYMENT FOR PRINCIPAL AND INTEREST WITH CREDIT	DOLLAR SAVINGS PER MONTH	DOLLAR SAVINGS PER YEAR
17%	14%	$855	$710	$145	$1740
16	13	806	663	143	1716
15	12	758	617	141	1692

ATTACHMENT 12.1

Share of Housing in National Output
1950 to 1984



ATTACHMENT 12.2

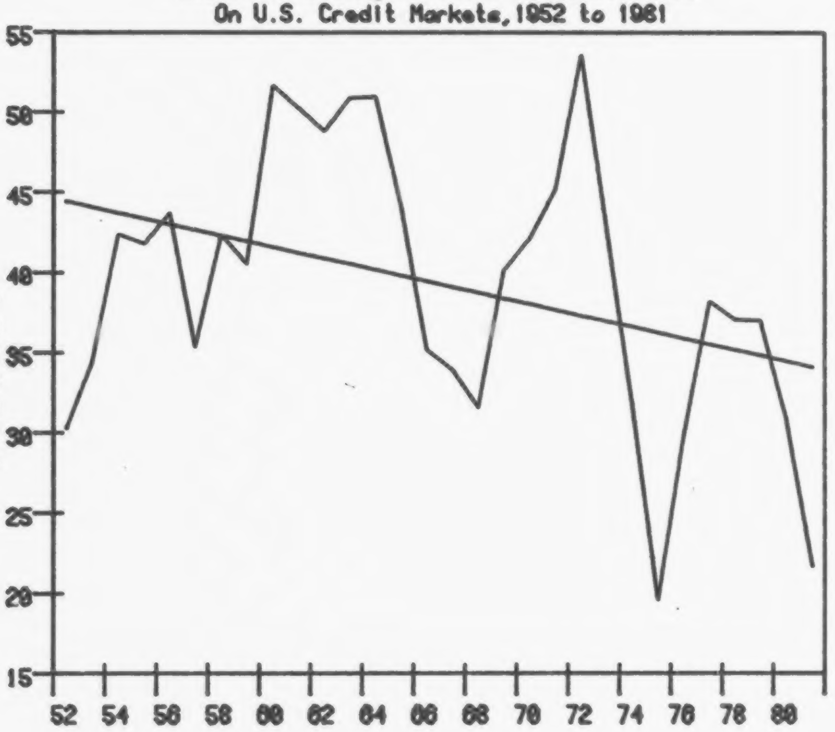
HOUSING AS A SHARE OF GNP

PERIOD	HOUSING SHARE OF NATIONAL OUTPUT
1950 - 1959 Average	4.8
1960 - 1969 Average	4.4
1970	3.8
1971	4.8
1972	5.4
1973	5.0
1974	3.9
1975	3.4
1976	3.9
1977	4.4
1978	4.3
1979	4.0
1980	3.2
1981	3.0
1982 (Forecast)	2.9
1983 (Forecast)	3.3
1984 (Forecast)	3.6

Source: National Income Accounts and estimates by the National Association of Realtors®.

ATTACHMENT 13

Share of Housing in Total Funds Borrowed On U.S. Credit Markets, 1952 to 1981



ATTACHMENT 14

NATIONAL ASSOCIATION OF REALTORS

REALTOR®

John R. Wood, President
Julio S. Laguarta, First Vice President
Jack Carlson, Executive Vice President

925 15th Street, N.W., Washington, D.C. 20005
Telephone 202 637 6800

January 21, 1981

Dear Association Member:

For more than 14 months now, the NATIONAL ASSOCIATION OF REALTORS®, on behalf of its more than 750,000 members, has been stressing the effect of poor economic policies on the housing industry.

However, it is not just our industry that has suffered and continues to be damaged by high inflation. Virtually every area of our nation's economy is feeling the burden of the poor mix of fiscal and monetary policies.

On both January 16 and January 19 we offered recommendations to the new administration and Congress and we stressed that we are willing to sacrifice in areas that affect housing and other real estate because in the long run we are confident our industry will benefit.

I am taking this opportunity to ask you to join in this approach -- sacrifice now for future economic strength -- and have enclosed the advertisement we employed and some of our material. First, insist that our government slow overall spending, reduce the federal deficit, provide tax relief directly for encouraging savings and investment as proposed in the attached advertisement we placed in major newspapers January 19. Second, do your part by recommending programs that benefit your industry be trimmed, as we have.

If we can be helpful to you, please call me at 202/637-6891.

Together we can get our economy and our industries back on track. And now is the most appropriate time to begin.

Sincerely,

Jack Carlson

Jack Carlson

Enclosures

ATTACHMENT 15

EXCERPT FROM STATEMENT OF THE NATIONAL ASSOCIATION OF REALTORS® TO SENATE BUDGET COMMITTEE

April 6, 1981

Because of the need for keeping spending reductions and tax relief linked and the need to stimulate savings, we recommend limiting across-the-board personal income tax relief to 5 percent annually over the next 3 years, starting no sooner than July 1981.

ATTACHMENT 16.1

FEDERAL HOUSING CREDIT PROGRAMS

In the last decade, rapid growth of Federal credit activity through direct loans, loan guarantees, and loan insurance has had a significant effect on the Nation's economy and on financial markets. We believe Congressional scrutiny, especially that of the Budget Committees, of this credit budget is essential to the total effort of reducing the growth of Federal spending. We urge caution, however, when changing the size or scope of the individual programs within the total credit budget. Each program should be understood and analyzed by its cost to the Government, the level of risk to which the program exposes the Government, the "crowding out" effect of each specific program and the policy reasons for continuing or ending the Government's support for the program.

The Administration has proposed limiting the use of Federal Housing Administration (FHA) insured mortgages to first-time homeowners or those areas which are not served by private mortgage insurers. FHA commitment level is to be capped at $35 billion after 1983. The role of FHA, which as a working partnership between Government and private enterprise has successfully delivered housing and mortgage finance to the American families for nearly fifty years, should not be altered during this period of depression in the housing industry. The non-subsidized FHA programs have operated since their inception as actuarially sound, user-fee supported programs that have helped to deliver affordable mortgage finance to homebuyers.

Rather than providing a subsidy to these homebuyers, FHA assists individuals to pool their risk to compete in credit markets with large corporate and international borrowers. The value of FHA insured loans to lenders comes from FHA's accessibility to the secondary mortgage market through the Government National Mortgage Association (GNMA). GNMA allows lenders to pool mortgages for investment as securities which have been able to compete for investor dollars as individual mortgages could never do. The GNMA mortgage-backed securities program is also an actuarially sound program which does not add to the Federal budget or the deficit.

The Administration proposes, however, to gradually reduce the commitment level of GNMA from the $68 billion for 1982 authorized by Congress to $48 billion in 1982 and $38 billion in 1983. The Administration suggests that limiting GNMA commitments will automatically shift its function to private mortgage-backed securities. But as the President's Commission on Housing has pointed out, while the Government should encourage a transfer of GNMA's function to the private sector, the Government must create the environment necessary for the private sector to fill the void. Simply limiting GNMA's commitment level will not work for the following reasons:

- Private mortgage-backed securities will never be a viable investment until the volatility of interest rate fluctation is reduced.

ATTACHMENT 16.3

- The Internal Revenue Code should be amended to place mortgage-backed securities on an equal footing with corporate securities. The gain on the discount upon sale of a corporate security is taxed as a capital gain (a maximum tax of 20 percent) while the gain on the discount upon sale of a mortgage-backed security must be taxed as ordinary income (a maximum tax of 50 percent).
- Placing continually decreasing commitment ceilings on GNMA will create problems of rationing the limited volume of available commitments.

Therefore, GNMA commitments should remain available on demand only to be replaced by private mortgage-backed securities as they are capable of bidding the business away from GNMA. An orderly transition to the private market will become especially crucial to the future of the housing industry if thrift institutions are allowed to reduce their housing commitment.

The Housing Commission recommends a continued role for governmental support of housing as a reinsurer of all mortgage-backed securities. This "moral support" for housing exposes government to little risk. Even the use of loan guarantees has significantly less overall crowding out propensity than direct Treasury borrowing, as former Council of Economic Adviser and President Reagan Adviser, Alan Greenspan, stated before the Senate Budget Committee panel on February 10th.

ATTACHMENT 16.4

There were important policy reasons for government to initiate its support of housing and those reasons remain essentially the same today--the economy of this country will never expand at the rate required for a recovery without a healthy housing industry.

ATTACHMENT 17.1

REALTORS® ECONOMIC PACKAGE

IMPACT OF SUBSTANTIALLY LOWER DEFICITS ON THE ECONOMY 1/
(Calendar Years)

	1982	1983	1984
Long Term Interest Rates (% Points)	-0.5	-1.6	-2.3
Housing Starts (Units)	105,000	350,000	550,000
Existing Home Sales (Units)	200,000	650,000	800,000
Investment in New Plant and Equipment (% Change)	0.6	2.8	3.5
Real Gross National Product (% Change)	0.3	0.6	0.9
Consumer Inflation (% Points)	-0.2	-0.4	-0.5
Spendable Income per Household ($)	$84	$185	$302
Employment	100,000	400,000	800,000

1/ Together with less restrictive credit policy

IMPACT OF INTEREST TAX CREDIT
(Calendar Years)

	1982	1983
Housing Starts (Units)	70,000	20,000
Existing Home Sales (Units)	155,000	
Real Gross National Product (% Change)	0.2	-
Employment	100,000	-

IMPACT OF EXPANDED MORTGAGE REVENUE BOND
(Calendar Years)

	1982	1983
Housing Starts (Units)	100,000	115,000
Existing Home Sales (Units)	250,000	325,000
Real Gross National Product (% Change)	0.3	0.4
Employment	200,000	300,000

ATTACHMENT 17.2

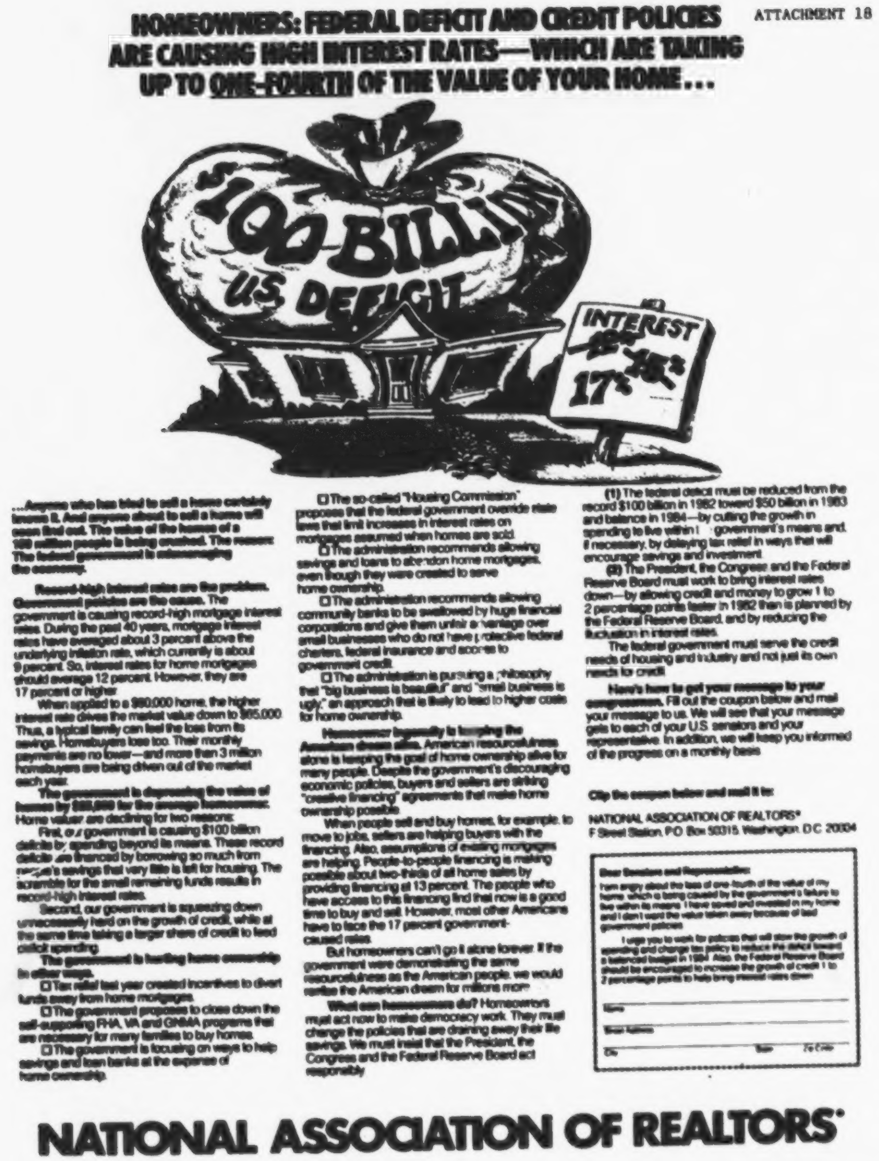
REALTORS® ECONOMIC PACKAGE

COMBINED IMPACT 2/
(Calendar Years)

	1982	1983	1984
Long Term Interest Rates (% Points)	-0.4	-1.3	-1.9
Housing Starts (Units)	200,000	450,000	550,000
Existing Home Sales (Units)	450,000	750,000	800,000
Investment in Commercial, Industrial and Agricultural Structures and Equipment (plant and equipment) % change	0.5	2.6	3.3
Real Gross National Product (% change)	0.5	0.8	1.2
Consumer Price Inflation (% points)	-0.2	-0.3	-0.2
Spendable Income per Household ($)	$140	$247	$403
Employment	200,000	600,000	800,000

2/ Aggregate impact differs from the sum of the components because of the interaction effect.

ATTACHMENT 18


$100 BILLION
U.S. DEFICIT
INTEREST
17%

HOMEOWNERS: FEDERAL DEFICIT AND CREDIT POLICIES ARE CAUSING HIGH INTEREST RATES—WHICH ARE TAKING UP TO ONE-FOURTH OF THE VALUE OF YOUR HOME . . .

. . . Anyone who has tried to sell a home certainly knows it. And anyone about to sell a home will soon find out. The value of the homes of a 100 million people is being crushed. The reason: The federal government is mismanaging the economy.

Record-high interest rates are the problem. Government policies are the cause. The government is causing record-high mortgage interest rates. During the past 40 years, mortgage interest rates have averaged about 3 percent above the underlying inflation rate, which currently is about 9 percent. So, interest rates for home mortgages should average 12 percent. However, they are 17 percent or higher.

When applied to a $80,000 home, the higher interest rate drives the market value down to $65,000. Thus, a typical family can feel the loss from its savings. Homebuyers lose too. Their monthly payments are no lower—and more than 3 million homebuyers are being driven out of the market each year.

The government is depressing the value of homes by $15,000 for the average homeowner. Home values are declining for two reasons:

First, our government is causing $100 billion deficits by spending beyond its means. These record deficits are financed by borrowing so much from people's savings that very little is left for housing. The scramble for the small remaining funds results in record-high interest rates.

Second, our government is squeezing down unnecessarily hard on the growth of credit, while at the same time taking a larger share of credit to feed deficit spending.

The government is hurting home ownership in other ways.

☐ Tax relief last year created incentives to divert funds away from home mortgages.

☐ The government proposes to close down the self-supporting FHA, VA and GNMA programs that are necessary for many families to buy homes.

☐ The government is focusing on ways to help savings and loan banks at the expense of home ownership.

☐ The so-called "Housing Commission" proposes that the federal government override state laws that limit increases in interest rates on mortgages assumed when homes are sold.

☐ The administration recommends allowing savings and loans to abandon home mortgages, even though they were created to serve home ownership.

☐ The administration recommends allowing community banks to be swallowed by huge financial corporations and give them unfair advantage over small businesses who do not have protective federal charters, federal insurance and access to government credit.

☐ The administration is pursuing a philosophy that "big business is beautiful" and "small business is ugly," an approach that is likely to lead to higher costs for home ownership.

Homeowner ingenuity is keeping the American dream alive. American resourcefulness alone is keeping the goal of home ownership alive for many people. Despite the government's discouraging economic policies, buyers and sellers are striking "creative financing" agreements that make home ownership possible.

When people sell and buy homes, for example, to move to jobs, sellers are helping buyers with the financing. Also, assumptions of existing mortgages are helping. People-to-people financing is making possible about two-thirds of all home sales by providing financing at 13 percent. The people who have access to this financing find that now is a good time to buy and sell. However, most other Americans have to face the 17 percent government-caused rates.

But homeowners can't go it alone forever. If the government were demonstrating the same resourcefulness as the American people, we would revive the American dream for millions more.

What can homeowners do? Homeowners must act now to make democracy work. They must change the policies that are draining away their life savings. We must insist that the President, the Congress and the Federal Reserve Board act responsibly.

(1) The federal deficit must be reduced from the record $100 billion in 1982 toward $50 billion in 1983 and balance in 1984—by cutting the growth in spending to live within the government's means and, if necessary, by delaying tax relief in ways that will encourage savings and investment.

(2) The President, the Congress and the Federal Reserve Board must work to bring interest rates down—by allowing credit and money to grow 1 to 2 percentage points faster in 1982 than is planned by the Federal Reserve Board, and by reducing the fluctuation in interest rates.

The federal government must serve the credit needs of housing and industry and not just its own needs for credit.

Here's how to get your message to your congressman. Fill out the coupon below and mail your message to us. We will see that your message gets to each of your U.S. senators and your representative. In addition, we will keep you informed of the progress on a monthly basis.

Clip the coupon below and mail it to:

NATIONAL ASSOCIATION OF REALTORS®
F Street Station, P.O. Box 50315, Washington, D.C. 20004

Dear Senators and Representative:

I am angry about the loss of one-fourth of the value of my home, which is being caused by the government's failure to live within its means. I have saved and invested in my home and I don't want the value taken away because of bad government policies.

I urge you to work for policies that will slow the growth of spending and change tax policy to reduce the deficit toward a balanced budget in 1984. Also, the Federal Reserve Board should be encouraged to increase the growth of credit 1 to 2 percentage points to help bring interest rates down.

Name

Street Address

City State Zip Code

NATIONAL ASSOCIATION OF REALTORS®

ATTACHMENT 19

JOINT STATEMENT OF

AMERICAN BANKERS ASSOCIATION
MORTGAGE BANKERS ASSOCIATION OF AMERICA
NATIONAL ASSOCIATION OF HOME BUILDERS
NATIONAL ASSOCIATION OF MUTUAL SAVINGS BANKS
NATIONAL ASSOCIATION OF REALTORS
U.S. LEAGUE OF SAVINGS ASSOCIATIONS

FEBRUARY 25, 1982

Prolonged high interest rates are creating an economic and financial crisis in this country. In order to bring interest rates down, immediate action must be taken to reduce massive federal budget deficits. More than anything else, it is the spectre of an overwhelming volume of deficit financing which haunts housing and financial markets and poses the threat of economic and financial conditions not seen since the 1930s.

Given these circumstances, there is no alternative to: (1) slowing down all spending, not excluding defense and entitlement progams; and, if necessary, (2) deferring previously enacted tax reductions or increasing taxes. In order to have the necessary impact on financial markets, these actions should be taken prior to any increase in the ceiling on the federal debt.

Even with these actions, the restoration of financial stability and safety will be a prolonged process. It is necessary, therefore, to adopt immediate but temporary measures to address the critical problems of the industries which finance, market and produce housing for American families. These industries have unfairly borne the brunt of destructively high interest rates. Unless immediate and effective short-run measures are adopted, the continued devastation of these industries will, directly and indirectly, aggravate the federal budget deficit and greatly increase the prospect of a general economic and financial crisis.

In times of past crises in this nation, our political leaders have come together in a bipartisan manner to develop effective solutions in the common interest. Our nation is at such a time now. There will be no political winners if the Administration and the Congress fail to accommodate differences and cooperate in dealing with current serious economic problems. The threat to our nation demands prompt, effective and bipartisan action.

Llewellyn Jenkins
Llewellyn Jenkins, President
American Bankers Association

Robert B. Masterton
Robert B. Masterton, Chairman
Mutual Savings Banks

James F. Aylward
James F. Aylward, President
Mortgage Bankers Association

Julio S. Laguarta, President
National Association of Realtors

Fred Napolitano, President
National Association of Home Builders

Roy G. Green, President
U.S. League of Savings Associations

ATTACHMENT 20

OVERRUN IN FEDERAL SPENDING CONTRASTED TO PRESIDENT'S ORIGINAL COMMITMENTS
(Dollars in Billions)

Fiscal Year	Initial (January) Budget Estimate	Actual Budget Spending	Spending Overrun	
			Percentage	Amount
1972	$229.2	$232.0	1.2	$2.8
1973	246.3	247.1	0.3	0.8
1974	268.7	269.6	0.3	0.9
1975	304.4	326.2	7.1	21.8
1976	349.4	366.4	4.9	17.0
1977	394.2	402.7	2.2	8.5
1978	440.0	450.8	2.4	10.8
1979	500.2	493.6	-1.3	-6.6
1980	531.6	579.6	9.0	48.0
1981	615.8	660.5	7.3	44.7
1982	695.3 (3/10/81)	May 15 -Congress 695.5e	0.0e	0.2e
		July 15 -President 704.8e	1.4e	9.5e
		Sept. 10 -CBO 723.0e	4.0e	27.7e
		Sept. 24 -President 709.3e	2.0e	14.0e
		Feb. 8 -President 729.2ef	4.9e	33.9e
		-REALTORS® 742.7ef	6.8e	47.4e
72-82 Average			3.7e	17.8e
1983	762.1f	Feb. 25 -CBO 785.1ef	1.7	13.0

e = estimate
f = adjusted for comparability by increasing $4.4 billion in 1983 and $3.9 billion in 1982 for SMI and VSI Insurance premiums excluded from spending figures starting in 1983 budget.

SOURCE: Budgets of the U.S. Government, First Concurrent Budget Resolution 1982, Congressional Budget Office Reports, and public statement of the President.

The NATIONAL ASSOCIATION OF REALTORS® is comprised of more than 1,806 local boards of REALTORS® located in every state of the Union, the District of Columbia, and Puerto Rico. Combined membership of these boards is nearly 700,000 persons actively engaged in sales, brokerage, management, counselling, and appraisal of residential, commerical, industrial, recreational and farm real estate. The activities of the Association's membership involve all aspects of the real estate industry, such as mortgage banking, home building, and commercial and residential real estate development, including development, construction and sales of condominiums. The Association has the largest membership of any association in the United States concerned with all facets of the real estate industry.

Elected Officers are: President Julio S. Laguarta, Houston, Texas; President-elect Harley W. Snyder, Valparaiso, Indiana; First Vice President Donald H. Treadwell, Sr., Southgate, Michigan; Treasurer Budd Krones, Tucson, Arizona.

The Chief Administrative Officer is Jack Carlson, Executive Vice President and Chief Economist.

The Senior Vice President, Government Affairs is Albert E. Abrahams and the Vice President and Legislative Counsel, Government Affairs is Gil Thurm.

Headquarters of the Association are at 430 North Michigan Avenue, Chicago, Illinois 60611. The Washington Office is located at 777 14th Street, N.W., Washington, D.C. 20005. Telephone 202/383-1000.

REALTOR®

STATEMENT OF

SAMUEL R. PIERCE, JR.

SECRETARY OF THE

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BEFORE THE

SENATE COMMITTEE ON THE BUDGET

THURSDAY, MARCH 11, 1982

I am pleased to appear before this Committee to discuss HUD's fiscal year 1983 budget proposals and the future direction of Federal support of subsidized housing and commmunity development.

The Fiscal Year 1983 Budget for HUD which has been submitted to the Congress is not a traditional budget document. It is a marked departure from the past and reflects a major redirection in the approach of the Federal Government to housing and urban development.

We are proposing significant changes in the way housing programs operate as well as the ways in which they are funded. At the same time, we will continue to meet our objective of providing housing assistance to those who most need such support.

The 1983 Budget does not propose to conduct business-as-usual. It reflects sharp reductions in spending and, indeed, the elimination of some programs, as the Department seeks to carry out its housing and urban development responsibilities more efficiently and effectively. As part of the President's Economic Recovery Program, we feel we can provide better quality services with less.

BEFORE DESCRIBING OUR PROGRAM, I WOULD LIKE TO PUT INTO CONTEXT THE APPROACH THIS DEPARTMENT IS TAKING AS IT RELATES TO THE MAJOR ECONOMIC GOALS OF THIS ADMINISTRATION. A PRIMARY GOAL OF THE ADMINISTRATION IS TO BRING THE RAMPANT INFLATION AND HIGH INTEREST RATES OF THE PAST SEVERAL YEARS UNDER CONTROL. UNLESS WE END THIS INFLATIONARY SPIRAL AND PLACE OUR GOVERNMENT ON A SOUND ECONOMIC FOOTING, WE FACE A DISASTROUS FUTURE.

THE PROGRAM PROPOSED BY THE PRESIDENT AND SUPPORTED BY THE CONGRESS--A SUBSTANTIAL REDUCTION IN THE GROWTH OF FEDERAL SPENDING, A 25 PERCENT CUT IN THE FEDERAL TAX BURDEN DURING THE NEXT THREE YEARS, THE PRUDENT ELIMINATION OF EXCESSIVE REGULATION, AND DEVELOPMENT OF A MONETARY POLICY GEARED TO STABILIZE AND REVITALIZE THE ECONOMY--IS ABSOLUTELY NECESSARY IF WE ARE TO SUCCEED.

DOUBLE-DIGIT INFLATION AND HIGH INTEREST RATES HAVE TAKEN THEIR TOLL ON ALL OF US. IN THE HOUSING INDUSTRY, THIS HAS BEEN REFLECTED DRAMATICALLY IN SOARING HOUSING COSTS THAT HAVE PRICED MOST AMERICANS OUT OF THE HOMEBUYING MARKET, AND HAVE CAUSED SEVERE HARDSHIPS FOR MANY HOMEBUILDERS, REALTORS AND OTHER AMERICANS WHOSE LIVELIHOOD DEPENDS ON A HEALTHY SHELTER INDUSTRY. THE HARSHEST BURDEN HAS FALLEN ON THOSE LOW-INCOME FAMILIES FOR WHOM ACHIEVEMENT OF THE GOAL OF

DECENT, SAFE AND SANITARY DWELLINGS HAS BECOME INCREASINGLY DIFFICULT.

THE ADMINISTRATION'S PROGRAM FOR ECONOMIC RECOVERY HAS ONLY RECENTLY BEGUN, AND IT WILL TAKE TIME TO REALIZE THE BENEFITS FROM IT. AS WE DEMONSTRATE OUR CONTINUING COMMITMENT TO THIS PROGRAM, I BELIEVE THERE WILL BE A DIRECT AND POSITIVE IMPACT ON HOUSING. AS INFLATION AND INTEREST RATES ARE BROUGHT UNDER CONTROL, THE HOUSING INDUSTRY SHOULD PROSPER AS THE PENT-UP DEMAND FOR HOUSING IS RELEASED, AND AMERICANS CAN ONCE MORE AFFORD TO PURCHASE AND FINANCE HOUSING.

CURRENT STATE OF THE HOUSING INDUSTRY

ALTHOUGH VIEWS VARY WIDELY ABOUT HOW TO ACHIEVE AN ECONOMIC TURNAROUND, THERE IS LITTLE DISAGREEMENT THAT THE NATION'S HOUSING INDUSTRY HAS SUFFERED A SEVERE DECLINE. HOUSING STARTS ARE AT THEIR LOWEST LEVELS SINCE THE HOUSING INDUSTRY RECOVERED AFTER WORLD WAR II, WITH MOST OF THE DECLINE OCCURRING IN THE SINGLE FAMILY SECTOR. IN 1981, ONLY 1.1 MILLION HOUSING UNITS WERE BUILT, 16 PERCENT FEWER THAN IN 1980, BUT 46 PERCENT FEWER THAN IN 1978, THE PEAK YEAR FOR HOUSING PRODUCTION.

The seasonally adjusted annual rate of starts was below 900,000 for each of the last 5 months, a series unprecedented in more than three decades. New home sales in 1981 were 426,000 units, the lowest on record, and a volume almost 48 percent below 1977 and 1978 levels, caused primarily by high and rising mortgage interest rates.

Of all the markets in our national economy, housing is particularly sensitive to variations in interest rates. It is because of this sensitivity that the housing sector has the most to gain from a sound fiscal policy. Increased spending on housing to offset the effects of high interest rates will only be self-defeating.

Further reductions, rather than increases, in spending are needed to reduce the Federal debt. Moreover, the housing industry has demonstrated that if Federal demands on the capital markets can be reduced, the private sector can effectively fulfill most of our housing production needs.

The FY 1983 Budget

Now let me turn to the FY1983 Budget. This budget is dramatically different from the HUD budgets in past years.

OUR OBJECTIVES ARE TWO-FOLD: 1) WE PROPOSE TO FOCUS OUR EFFORTS ON PRESERVING AND UPGRADING EXISTING HOUSING AND PROVIDING MORE CHOICE FOR FAMILIES NEEDING ASSISTANCE, AND 2) WE PROPOSE AT LONG LAST TO HALT THE RAPIDLY ESCALATING FEDERAL HOUSING DEBT BURDEN.

AS THE MEMBERS OF THIS COMMITTEE ARE AWARE, HUD'S ANNUAL BUDGET--BECAUSE OF THE NATURE OF LONG-TERM COMMITMENTS FOR SUBSIDIZED HOUSING CONSTRUCTION--INCLUDES BUDGET AUTHORITY NOT JUST FOR A SINGLE FISCAL YEAR, BUT FOR 25, 30, OR 40 YEARS OF THE FEDERAL SUBSIDY PAYMENT ATTACHED TO EACH HOUSING UNIT. AS A RESULT, THE BUDGET AUTHORITY COST OF THE FEDERAL HOUSING SUBSIDY PROGRAM HAS GROWN TO NEARLY A QUARTER OF A TRILLION DOLLARS IN JUST SIX YEARS. HUD COMMITMENTS AT THE END OF 1982 WILL CONSTITUTE THE EQUIVALENT OF ONE-FOURTH OF THE TOTAL NATIONAL DEBT. THIS TREND MUST BE REVERSED--AND OUR 1983 BUDGET BEGINS SIGNIFICANT MOVEMENT IN THAT DIRECTION.

THE FY 1983 BUDGET PROPOSES TO REDUCE HUD'S QUARTER OF A TRILLION DOLLARS IN OBLIGATIONS, THE LONG-TERM COMMITMENTS WHICH DRIVE OUTLAYS UPWARD IN FUTURE YEARS. WE BELIEVE IT IS TIME TO CONTROL WHAT HAS IN THE PAST BEEN VIEWED AS UNCONTROLLABLE AND THUS RELIEVE THE EVER-UPWARD PRESSURE ON OUTLAYS. IN OUR VIEW, THIS IS SOUND FISCAL POLICY--AND A

SOUND FISCAL POLICY IS THE BEST HOUSING POLICY. I WOULD ALSO ADD THAT THIS IS GOOD MANAGEMENT AS WELL.

AT HUD, A RECENT SURVEY BY THE INSPECTOR GENERAL, IN CONJUNCTION WITH A REPORT TO THE PRESIDENT'S COMMISSION ON INTEGRITY AND EFFICIENCY, POINTED OUT THAT THERE ARE SUBSTANTIAL OBLIGATED BALANCES OF FUNDS TIED UP IN CONSTRUCTION PROGRAMS--INCLUDING THE SUBSIDIZED HOUSING PROGRAMS--WHERE THERE IS ABSOLUTELY NO CHANCE OF THE PROJECT PROCEEDING. REMOVING FROM THE PIPELINE UNITS THAT WILL NEVER BE BUILT IS A LONG OVERDUE MANAGEMENT REFORM.

HOUSING PROGRAMS

LET ME TURN NOW TO THE MAJOR HOUSING INITIATIVES IN OUR FY1983 BUDGET.

THE HOUSING PROBLEMS OF LOW INCOME FAMILIES FALL INTO TWO BASIC CATEGORIES: EXCESSIVE COST AND SUBSTANDARD QUALITY. THE ADMINISTRATION'S BUDGET ADDRESSES BOTH OF THESE PROBLEMS.

BY FAR THE MOST IMPORTANT PROBLEM TODAY IS EXCESSIVE COST. OVER TIME, IMPROVEMENT IN ECONOMIC CONDITIONS HAS

RESULTED IN AN OVERALL UPGRADING OF THE HOUSING STOCK. HOWEVER, PEOPLE WITH LITTLE INCOME INCREASINGLY HAVE HAD TO PAY LARGER PROPORTIONS OF THEIR INCOME FOR RENT, OR SETTLE FOR THE REMAINING SUBSTANDARD HOUSING.

NINETY PERCENT OF ALL VERY LOW INCOME RENTERS NOT ALREADY SERVED BY OUR PROGRAMS HAVE EITHER A COST OR QUALITY HOUSING PROBLEM. OVER A THIRD OF THESE LIVE IN STANDARD HOUSING BUT PAY TOO LARGE A SHARE OF THEIR INCOME FOR IT. ABOUT SAME NUMBER LIVE IN HOUSING WHICH DOES NOT MEET QUALITY STANDARDS, BUT WHICH CAN BE REPAIRED FOR A SMALL AMOUNT OF MONEY.

IN MOST BASIC TERMS, THIS MEANS THAT THE HOUSING PROBLEMS OF ALMOST THREE-FOURTHS OF THE VERY LOW INCOME RENTER GROUP CAN BE ADDRESSED WITH ASSISTANCE TO HELP PAY THE RENT, AND AN INDUCEMENT FOR THE LANDLORD OR TENANT TO MAKE MINOR REPAIRS. THE MODIFIED CERTIFICATE MAKES SENSE FOR THESE FAMILIES.

THE COST OF PROVIDING A HOUSING CERTIFICATE FOR ASSISTANCE IN RENTING AN EXISTING UNIT IS ONE-THIRD THAT OF BUILDING AND SUBSIDIZING A NEW OR SUBSTANTIALLY REHABILITATED UNIT.

Assistance for Special Needs. We recognize that there are persistent, difficult problems of housing stock quality. It can be argued that general economic recovery will produce sufficient increases in stock to make subsidies for new construction or rehabilitation wholly unnecessary. But, to address local needs for rehabilitation of stock and neighborhood preservation, and the particular requirements of the elderly and handicapped, we have made special provision in the budget.

First, the new construction loan program for elderly and handicapped, the Section 202 program, will be continued. Second, the Administration proposes a new rental rehabilitation program, to replace the costly and cumbersome ones currently in operation. This program will address the need to upgrade substandard housing units in various market areas by providing rental rehabilitation grants to State and local governments, and by giving tenants rental assistance which they may use to stay in their rehabilitated units or to select housing elsewhere.

Modified Section 8 Certificate. Perhaps the most controversy has been raised by the Department's proposed use of "vouchers." In fact, the proposal is essentially a

CONTINUATION OF THE SECTION 8 EXISTING HOUSING PROGRAM, WITH CERTAIN MODIFICATIONS TO MAKE IT EVEN MORE EFFECTIVE. THE SECTION 8 EXISTING PROGRAM WORKS QUITE WELL. IT IS CURRENTLY SERVING OVER 700,000 FAMILIES NATIONWIDE.

THE MODIFIED CERTIFICATE PROGRAM WILL BE STRUCTURED IN MUCH THE SAME WAY AS THE SECTION 8 EXISTING HOUSING PROGRAM WITH PAYMENTS CONTINUING TO GO DIRECTLY TO THE OWNER. HOUSING UNITS WILL BE INSPECTED ANNUALLY AND WILL BE REQUIRED TO MEET HOUSING QUALITY STANDARDS.

INSTEAD OF HAVING RENT "CAPPED" BY AN ESTABLISHED "FAIR MARKET RENT," AS IN THE CURRENT SECTION 8 EXISTING HOUSING PROGRAM, TENANTS WILL BE GIVEN A SET SUBSIDY, BASED ON THEIR INCOME AND THE RELATIVE HOUSING COSTS IN THE AREA, TO APPLY TOWARD RENT IN THE UNIT OF THEIR CHOICE. IF THEY FIND "BARGAINS" MEETING HOUSING QUALITY STANDARDS, THEY CAN POCKET THE DIFFERENCE BETWEEN THE SUBSIDY AND THE SAVINGS, AS LONG AS A MINIMUM PAYMENT IS MADE. IF THEY WANT TO SELECT A MORE EXPENSIVE UNIT, THEY MUST MAKE UP THE DIFFERENCE THEMSELVES.

WE ARE CONFIDENT THAT THIS CHANGE IN PROGRAM DESIGN WILL OPEN UP A WIDER VARIETY OF UNITS TO PROGRAM PARTICIPANTS, AND ENCOURAGE THEM TO NEGOTIATE RENTS MORE EFFECTIVELY THAN THEY

HAVE UNDER THE SECTION 8 EXISTING HOUSING PROGRAM, WHERE RENTS HAVE OFTEN RISEN 20-30 PERCENT WHEN A TENANT ENTERED THE PROGRAM.

THE KEYSTONE OF THE MODIFIED CERTIFICATE PROGRAM IS FLEXIBILITY. WE FEEL THAT TENANTS WILL BE BETTER SERVED IF THEY HAVE MORE CHOICE IN SELECTING WHERE THEY LIVE. UNDER THE MODIFIED CERTIFICATE PROGRAM, A FAMILY WILL BE ABLE TO RECEIVE A SUBSIDY IN ITS PRESENT HOUSING UNIT IF THE UNIT ALREADY MEETS HOUSING STANDARDS OR CAN BE REPAIRED TO MEET THEM. ALTERNATIVELY, THE FAMILY COULD MOVE TO ANOTHER UNIT MEETING CURRENT STANDARDS AND STILL RECEIVE THE SUBSIDY.

CRITICS OF MODIFIED SECTION 8 CERTIFICATES CONTEND THAT LOW VACANCY RATES WILL PREVENT MANY LOW INCOME FAMILIES FROM FINDING AFFORDABLE HOUSING THAT MEETS HUD STANDARDS. THE EVIDENT SUCCESS OF THE CURRENT PROGRAM THROUGHOUT THE NATION SUGGESTS THAT IS NOT TRUE.

THE HOUSING PROBLEMS OF LOW-INCOME FAMILIES WILL NOT BE SOLVED WITH COSTLY PRODUCTION PROGRAMS. THE ABSENCE OF NEW MODERATE COST RENTAL HOUSING IN SOME PARTS OF THE COUNTRY IS A REFLECTION OF HIGH INTEREST RATES AND CONSTRUCTION COSTS, AND THE BEWILDERING ARRAY OF LOCAL REGULATIONS WITH WHICH LANDLORDS MUST CONTEND. THESE FACTORS HAVE DECREASED THE

PROFITABILITY OF RENTAL HOUSING. AS A RESULT, LANDLORDS WHO CAN GET OUT OF THE BUSINESS DO SO EITHER BY CONVERTING TO CONDOMINIUMS OR BY ABANDONMENT. NO AMOUNT OF FEDERAL ASSISTANCE FOR HOUSING PRODUCTION WILL REVERSE THIS TREND.

WHILE THE MODIFIED CERTIFICATE PROGRAM WILL NOT DIRECTLY STIMULATE DEVELOPERS TO BUILD MORE HOUSING FOR LOW-INCOME FAMILIES, IT WILL INCREASE THE STOCK OF STANDARD-QUALITY HOUSING BY INDUCING REPAIRS. ANNUAL REINSPECTIONS WILL RESULT IN GREATER ATTENTION TO REPAIRS AND MAINTENANCE WHICH ARE ESSENTIAL TO AVOID THE NEED FOR MAJOR REHABILITATION LATER ON.

THE MODIFIED CERTIFICATE PROGRAM OFFERS AN AFFORDABLE AND PRACTICAL APPROACH TO PROVIDING ASSISTANCE TO LOW-INCOME FAMILIES. IT IS COMPLEMENTED BY A PROGRAM TO REHABILITATE EXISTING STOCK. THE ADMINISTRATIONS'S BUDGET IS NOT ONLY APPROPRIATE BECAUSE OF LIMITED FEDERAL RESOURCES, BUT BECAUSE IT ADDRESSES THE HOUSING NEEDS OF THE POOR IN A DIRECT AND STRAIGHTFORWARD WAY. IT MAKES GOOD BUDGET SENSE--AND GOOD HOUSING SENSE.

PUBLIC HOUSING. OUR EMPHASIS ON PRESERVATION ALSO EXTENDS, OF COURSE, TO THE EXISTING PUBLIC HOUSING STOCK.

We propose to give Public Housing Authorities the option of converting half of the deobligated budget authority in their pipeline of unstarted commitments to needed modernization and rehabilitation activity.

I have often been told by local officials that they would much rather have funds to renovate their old structures than be forced to accept more money for building new ones when their existing inventory is run down. We expect to devote $1.8 billion of budget authority in each of fiscal years 1982 and 1983 to upgrading public housing. At the same time, we are also concentrating our attention on the management practices and operating costs of public housing authorities.

There has been a skyrocketing increase in the funds being used for public housing operating subsidies. In 1965, PHA's received $1.5 million in subsidies. In 1969, the subsidy had grown to $12.6 million. In 1981, it passed the billion dollar mark at $1.1 billion. In recent years, the operating subsidy has been viewed as one of the "uncontrollable" programs in the Federal budget.

We are taking action to control this program. We intend to assure that funds are used in an efficient and effective manner and that the taxpayer does not pay for massive increases in utility consumption--utility costs being over half the total cost of public housing--when that consumption can be restrained by the PHA.

We also plan to allow PHA's to demolish structurally unsound or unviable projects when, in their judgment, that is the wisest course of action and thus stop draining the Federal Treasury for the maintenance of projects which, in fact, cannot be maintained.

Credit programs. The credit programs of Department of Housing and Urban Development constitute the largest single portion of the Federal Credit Budget. As indicated in the President's Budget, large Federal credit demands impede the Nation's ability to improve investment and productivity, exacerbate inflationary expectations and place upward pressure on both interest rates and inflation.

The HUD Budget contains two major credit programs--the Federal Housing Administration's Insurance activity and the Government National Mortgage Association's Guarantees of Mortgage-Backed Securities Program. The commitment levels in both programs are proposed at lower levels for FY 1983 than

THOSE ENACTED FOR FY 1982 AND REFLECT WHAT WE REASONABLY PROJECT TO BE THE DEMAND IN THOSE MARKETS.

EVEN WITH LOWER COMMITMENT LEVELS, THE ACTUAL AMOUNT OF INSURANCE WRITTEN AND GUARANTEES ISSUED IS EXPECTED TO BE GREATER IN 1983 THAN IN 1981 OR 1982.

FHA HAS A MAJOR ROLE TO PLAY IN HELPING TO ASSURE THAT FIRST-TIME HOMEBUYERS AND INNER CITY RESIDENTS HAVE ACCESS TO FINANCING TAILORED TO THEIR NEEDS. FOR THE NEXT FIVE OR SIX YEARS THE NUMBERS OF SUCH POTENTIAL HOMEBUYERS WILL BE AT HISTORICALLY HIGH LEVELS. THE MAJORITY OF THESE POTENTIAL BUYERS DO NOT NEED MORE FEDERAL SUBSIDIES IN ORDER TO AFFORD HOMEOWNERSHIP. INSTEAD, THEIR NEED IS FOR LOW DOWNPAYMENT AND/OR REDUCED INITIAL PAYMENT LOANS, PRODUCTS THAT THE PRIVATE MORTGAGE INSURANCE INDUSTRY HAS NOT INSURED ON ANYTHING LIKE THE SCALE THAT FHA HAS PROVIDED.

IT SEEMS LIKELY THAT OVER THE LONGER TERM PRIVATE INSURERS MAY BE ABLE TO ACCOMMODATE FIRST-TIME BUYERS, BUT THIS WILL HINGE ON CHANGES IN STATE LAWS WHICH PREVENT NEGATIVE AMORTIZATION; PROVIDING INDUCEMENTS TO LENDERS TO ORIGINATE CONVENTIONALLY FINANCED GPMS; IMPROVEMENT IN THE FINANCIAL POSITION OF THE THRIFT INDUSTRY, THE TRADITIONAL originators of privately insured loans, and less implicit price competition for higher risk loans by FHA. However, until it is clear that private insurers can serve a large market of first-time homebuyers, FHA must be available for these buyers.

Furthermore, we recommend that the prohibition on FHA's insuring of loans with variable rates be dropped and that FHA innovation with alternative mortgage instruments, such as shared appreciation mortgages, be encouraged. These instruments hold the promise of inducing non-traditional lenders to participate more actively in the mortgage market. Their participation will have a salutary effect on the stability of the supply of mortgage credit, which, in turn, will help reduce cyclical unemployment in the construction industry. Instruments, such as the shared appreciation mortgage, will also benefit first-time homebuyers by reducing monthly payments.

Community Development

The FY 1983 Budget also recognizes the importance which the Administration places on economically and socially viable communities by continuing the Community Development Block

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Grant Program at a $3.456 billion level. In addition, the budget recognizes the need to increase private investment and jobs in distressed areas and in the Nation as a whole. For this purpose, the Urban Development Action Grant Program is being continued at a $440 million level. Urban Homesteading is also being stressed with the first appropriation request for this program since 1979, and with a special proposal to test multifamily urban homesteading.

Summary

In summary, the FY1983 Budget for HUD is a responsible approach to meeting the housing and community development needs of the nation. It is linked directly to the problems of the poor and addresses the needs of the first-time homebuyer as well.

Under our proposals, occupied subsidized housing units will continue to increase from some 3.4 million at the end of 1981 to about 3.8 million by the end of 1985. HUD subsidized production will continue to be available for the special needs of the elderly and handicapped. At the same time we are able to propose major reductions in Budget authority and even reflect some decrease in outlays in 1983.

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Mortgage Bankers Association of America

STATEMENT OF

DR. MARK J. RIEDY
EXECUTIVE VICE PRESIDENT

on behalf
of the

MORTGAGE BANKERS ASSOCIATION OF AMERICA

before the

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

Hearings on

FY 1983 Budget Proposals and Their Impact
on Housing and Mortgage Markets

March 11, 1982

Mr. Chairman and Members of the Committee, my name is Dr. Mark J. Riedy. I am Executive Vice President of the Mortgage Bankers Association of America.* MBA is the trade association of the Nation's mortgage banking industry. Accompanying me are Burton C. Wood, MBA's Legislative Counsel, and Sharon M. Canavan, MBA's Associate Legislative Counsel.

We appreciate the opportunity to appear before you today to express our views on the impact of the FY 1983 budget on the housing and mortgage markets. In addition, our comments will focus specifically on the disruptive effects of setting ceilings on the non-subsidized, user-fee supported Federal Housing Administration (FHA) mortgage insurance and Government National Mortgage Association (GNMA) mortgage-backed security (MBS) guaranty programs, as well as the possible impact on the Veterans Administration (VA) home loan guaranty program. We will also comment on the impact of cuts in the assisted housing programs on the viability of multifamily housing production.

This nation is facing an economic crisis today. The crisis is one of conflict between our fiscal and our monetary policies, and the result is exploding government deficits crowding out private spending and causing record high interest rates. High interest rates have been slowly destroying our interest-rate-sensitive industries, especially in the housing field. Recognizing the need for action, MBA and five other major trade associations recently issued the following joint letter to the President and the Congress, urging that swift, bipartisan action be taken to reduce projected Federal government deficits:

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*The Mortgage Bankers Association of America is a nationwide organization devoted exclusively to the field of mortgage and real estate finance. MBA's membership comprises mortgage originators, mortgage investors, and a variety of industry related firms. Mortgage banking firms, which make up the largest portion of the total membership, engage directly in originating, financing, selling, and servicing real estate investment portfolios. Members include:

- Mortgage Banking Companies
- Mortgage Insurance Companies
- Life Insurance Companies
- Commercial Banks
- Mutual Savings Banks
- Savings and Loan Associations
- Pension Funds
- Mortgage Brokers
- Title Companies
- State Housing Agencies
- Investment Bankers
- Real Estate Investment Trusts

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An Open Letter to President Reagan and Members of Congress

March 3, 1982

Prolonged high interest rates are creating an economic and financial crisis in this country. In order to bring interest rates down, immediate action must be taken to reduce massive federal budget deficits. More than anything else, it is the specter of an overwhelming volume of deficit financing which haunts housing and financial markets and poses the threat of economic and financial conditions not seen since the 1930s.

Given these circumstances, there is no alternative to: (1) slowing down all spending, not excluding defense and entitlement programs; and, if necessary, (2) deferring previously enacted tax reductions or increasing taxes. In order to have the necessary impact on financial markets, these actions should be taken prior to any increase in the ceiling on the federal debt.

Even with these actions, the restoration of financial stability and safety will be a prolonged process. It is necessary, therefore, to adopt immediate but temporary measures to address the critical problems of the industries which finance, market and produce housing for American families. These industries have unfairly borne the brunt of destructively high interest rates. Unless immediate and effective short-run measures are adopted, the continued devastation of these industries will, directly and indirectly, aggravate the federal budget deficit and greatly increase the prospect of a general economic and financial crisis.

In times of past crises in this nation, our political leaders have come together in a bipartisan manner to develop effective solutions in the common interest. Our nation is at such a time now. There will be no political winners if the Administration and the Congress fail to accommodate differences and cooperate in dealing with current serious economic problems. The threat to our nation demands prompt, effective and bipartisan action.

Llewellyn Jenkins, President
American Bankers Association

James F. Aylward, President
Mortgage Bankers Association

Fred Napolitano, President
National Association of Home Builders

Robert R. Masterton, Chairman
National Association of Mutual Savings Banks

Julio S. Laguarta, President
National Association of Realtors

Roy G. Green, Chairman
U.S. League of Savings Associations

Joint Statement of: American Bankers Association, Mortgage Bankers Association of America, National Association of Home Builders, National Association of Mutual Savings Banks, National Association of Realtors, U.S. League of Savings Associations

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The current recession is, in part, responsible for this year's Federal government budget deficit. In normal times, the end of recession would reduce the deficit as tax revenues rise with rising profits and incomes, and as government transfer payments for unemployment and other assistance fall. The primary problem of the current deficit, though, is that it will grow and not shrink as the economy begins to recover. That is, the scheduled tax cuts and defense and entitlement spending increases will more than offset any increased tax revenues from increased profits and incomes and other spending reductions. This expansionary fiscal policy would generate new inflationary pressures, if it were not for the restrictive monetary policy adopted by the Federal Reserve. While the restrictive monetary policy is successfully bringing inflation under control, it also causes record high interest rates. It is these high interest rates that have caused the current recession, imposing high costs on the economy in terms of slow or no growth, high unemployment, and low utilization of our productive capacity.

The current conflict between a tight monetary policy and an expansionary fiscal policy has resulted in:

1) historically high rates of interest;
2) continued recession and risk of a stalled recovery;
3) high unemployment; and
4) destruction of key industries heavily dependent on credit—especially housing, automobiles, and agriculture.

The inflation problem of the 1970's required restrictive monetary policy. This policy, followed since October 1979, has been costly but is producing positive results. Now that inflation is coming under control, the Federal Reserve could consider easing its policy. However, excessively expansionary fiscal policy is forcing the Federal Reserve to keep monetary policy tight to avoid a resurgence of inflation.

So long as tight monetary policy keeps interest rates at or near record high levels, it will continue the gradual destruction of interest-rate-sensitive industries, such as housing, agriculture, automobiles, and other consumer durables. Soon the effects will hit public utilities, manufacturing, and other sectors heavily dependent on borrowed capital.

Chairman Volcker has testified that only a more restrictive fiscal policy can permit a relaxation of monetary policy and lower interest rates. In order to achieve a sustainable economic recovery this year, Congress and the Administration must reduce fiscal pressures by reducing the deficit, beginning in fiscal year 1983. This reconciliation of fiscal and monetary policy is the only way to bring about a relaxed monetary policy, which is the only way to reduce interest rates.

There are, of course, two ways to reduce deficits—reduced spending and increased tax revenue.

We believe it is imperative that the Congress carefully evaluate all government spending plans for FY 1983 through 1985, including both defense spending and increases in entitlement programs, including social security. Although the international situation argues for increased spending on defense, it is questionable whether our industrial base and our defense bureaucracy can efficiently spend an additional $33 billion in fiscal year 1983. If such an increase in a short period of time exceeds our physical and managerial capacity to augment defense, then the excess dollars will be wasted or will push up prices. An excessive push in defense, in the absence of an extended recession or a national emergency, would have additional damaging effects on the economy. It would compete with the private sector for machine tools, materials, and industrial capacity at just the time when the private sector heavy goods industry will be recovering, putting upward pressure on prices in those sectors that will be passed along to consumers later on. In addition, the massive financing requirements for both defense and industrial production will put upward pressure on interest rates, at a time when government credit demands still will be high.

Defense spending also tends to be inflationary. The production of defense goods and services increases national income without increasing the stock of goods and services available for consumers to buy. The result is that consumer prices tend to be bid upward, inflating the economy. Since investors require a premium for inflation, interest rates are pushed upward as well. Unfortunately, the President's defense program, because of its massive size, will conflict with the recovery. The Congress should carefully review defense spending plans, to provide the defense capabilities we need over a reasonable period of time, consistent with our other needs and consistent with our productive capacity. Deferral of a portion of the planned defense buildup offers two benefits. First, any spending deferrals for the FY 1983 budget will reduce the deficit by a like amount, reducing pressure on Federal financing. Second, deferrals will allow the needed defense projects to be more carefully planned and reviewed. As a result, less useful projects may be identified and delayed or cancelled while more promising projects that are delayed may be better administered and benefit from emerging technology.

On the entitlements side, social security spending is growing by about $15 to $20 billion in each of the next few years. Benefit levels are now much higher than were promised when current recipients began paying taxes into the program. Since these extra benefits, those in excess of the actuarially sound level based on contributions, are not subject to income tax, they constitute a double windfall gain that this nation can ill afford. Our generosity toward the eligible retired is especially troubling at a time when we have reduced public assistance to many lower-income recipients of numerous assistance programs. The Congress should carefully review the Social Security budget, to review not only the financial soundness of the program but also the level of benefits and the automatic indexing of benefits for a select group already benefitting from a large windfall gain.

If spending cuts sufficient to control the deficit cannot be achieved, then tax revenue increases should be considered. However, the Congress should take note of the importance of our reduced marginal income tax rates in encouraging saving and investment in the domestic economy. Any tax increases should be temporary and should be designed to minimize their potential negative impact on savings and investment.

HOUSING AND MORTGAGE MARKET OUTLOOK

The slow monetary growth philosophy of the Federal Reserve Board is a major cause of the depressed state of the housing industry. High financing costs for home builders and potential buyers kept 1981 housing starts below 1980 levels, slightly below 1.1 million total starts, the lowest volume in at least 20 years. Of this number, approximately 290,000 were multifamily starts, mostly condominiums. New residential construction in 1982 will be only slightly better, with starts for the year at a level no higher than 1.3 million units. Between 350,000 and 450,000 of the 1982 starts will be in multifamily structures, again predominantly condominiums. In the resale market, the problems are even more apparent. In 1981, existing home sales were only 2.35 million units, down 20 percent from 1980's depressed sales and almost 40 percent below the levels of 1978 and 1979. Most observers expect existing home sales to rebound to the 2.5 - 2.8 million unit range this year.

Clearly, the low level of housing construction of the past two years has been a disaster for the industry. But it also represents a disaster for the consumer. Most estimates of population and household formation rates envision the decade of the Eighties as one of continued increasing housing demand. While the general population will increase by 21 million people in this decade, the population of the prime first-time home buying group, those between 25 and 34 years, will grow by nine million persons. This growth will be three times faster than the overall population growth rate. Many analysts foresee a demand in excess of 2 million additional housing units per year during the next decade. Even with a limited housing recovery this year, 1982's projected 1.3 million starts will fall far short of demand. The following table shows the level of new housing starts over the past six years:

TABLE 1

Year	Private Housing Starts (Seasonally Adjusted Annual Rate)
1976	1,537,000
1977	1,987,000
1978	2,020,000
1979	1,745,000
1980	1,292,000
1981	1,086,000

Source: Dept. of Commerce, Bureau of the Census.

Some of the shortfall in supply will be made up by the conversion of commercial properties to residential use. The shortage of housing, however, in the face of strong potential demand will cause a significant increase in "doubling up," an eventual resumption of the upward spiral of home prices, and continued conversion of rental units to satisfy ownership demands. Further, countless American families will be forced to occupy rental housing far longer than they prefer, or perhaps forever, never being able to afford a home of their own.

The most important issue of housing policy during the next twelve months, and, quite conceivably for the entire decade of the eighties, will be the affordability of housing. The current high interest rates have focused increasing concern on a problem that has been worsening for several years. The number of people who can afford to buy homes has been declining, and mortgage rates far above historical averages have exacerbated the problem. For 1981, the median price of a new one-family home sold was $68,900. Assuming a normal downpayment of about 10 percent, the outstanding principal balance of a standard mortgage would exceed $62,000. With a level payment 30-year mortgage bearing a contract rate of 14 percent (the prevailing conventional commitment rate only one year ago), some 23 percent of American families could have afforded to buy that home. At 16 percent, only slightly more than 17 percent of those families could afford it. And at 18 percent mortgage rates, a level we have reached and even exceeded in some areas, the number of families that can afford this median price home falls to about 12 percent. Unable to qualify willing buyers for loans, the housing industry is moribund.

One critical cause of the affordability crisis in housing is the historically high cost of mortgage credit. Several factors are to blame—some macroeconomic or more general in nature and others related more directly to the severe plight of the mortgage lending industry. The general causes—inflation expectations, excessive Federal deficits, and restrictive monetary policy—have already been detailed.

The problems specific to the mortgage lending industry, unfortunately, have been all too well documented in the trade and financial press. Scores of savings and loan associations and mutual savings banks have been, or are threatened with forced merger and acquisitions, or outright failure. Well-managed institutions, as well as poorly run firms, have been victimized by piecemeal deregulation during a period of extraordinarily adverse financial conditions. The mortgage banking industry, which in recent years has accounted for approximately one-quarter of the residential loan market, has seen large and small firms—most of them successfully operated for decades—pushed into retrenchment, forced sales, and failures. It can come as no surprise, therefore, that the availability of mortgage credit has been severely curtailed, and its cost forced to exorbitant levels.

The crisis among mortgage lending institutions is real, and threatens to get even worse before it can pass. As highlighted in the joint letter to the President and the Congress, unless immediate and effective short-run measures are adopted, the economic and human costs of the continued devastation of these industries will be great. It is most difficult to comprehend, much less put a price tag on, the general economic and financial crisis that will result from the massive problems threatening these industries.

Under present economic conditions and prospects, the most optimistic forecast of mortgage rates during 1982 would be a low of 14-15 percent by early summer, with rates gradually rising during the second half of the year. This forecast results primarily from the overall easing of interest rates in response to the recession-induced weakness of business and consumer credit demands. Tight monetary policy and the bloated credit demands arising from the huge Federal deficit mitigate against further declines in interest rates while simultaneously exacerbating the crisis conditions plaguing mortgage lenders. Without immediate relief targeted toward the housing and mortgage markets, no better prospects can be projected in good faith.

The key roles played by the real estate, housing, and mortgagee finance industries in the overall well-being of the U.S. economy cannot be overlooked. Without a recovery in these critical domestic industries, the outlook for a resumption of real growth in the economy generally is not favorable—and may be impossible if the housing and mortgage lending industry crises materialize with the full vigor that appears likely.

FHA AND GNMA-MBS CREDIT BUDGET LIMITATIONS

MBA opposes setting limits on these self-supporting programs. However, if limits are to be established they should be set high enough to accommodate demand. The Administration in its FY 1983 budget proposal has requested that the GNMA Mortgage-Backed Security (MBS) program be restricted to $38.4 billion, and the FHA mortgage insurance programs be limited to $35 billion. The Administration has also proposed a "supplemental reduction" in the FY 1982 GNMA-MBS level of $20.25 billion to bring it to a ceiling of $48 billion.

MBA is seriously concerned that even if interest rates remain at or near their current levels, the $38.4 billion limit for the GNMA-MBS program will prove insufficient. If interest rates drop and proposals to create several alternative financing proposals are successful, the FHA commitment ceiling may prove insufficient. Therefore, MBA recommends that the FY 1983 ceilings be set at the same limits established for FY 1982—$40 billion for the FHA mortgage insurance programs and $68.25 billion for the GNMA-MBS program. MBA also opposes any reduction in the FY 1982 GNMA-MBS levels of $68.25 billion.

In addition, MBA supports the inclusion of procedural protections in a credit budget for these self-supporting programs. First, anti-impoundment protections should be included so that the Congressionally approved limits cannot be rolled back by administrative fiat. Second, a system to alert the appropriate committees, if the ceilings are approached, should be instituted to give Congress sufficient time to react. Third, the procedures established for adjusting ceilings, in the event they are reached, should be streamlined to avoid market disruptions. Prior to 1961, when limits were placed by the authorizing committees on FHA insurance levels, these ceilings created serious disruptions in the mortgage market whenever they were reached. Recognizing this, Congress instituted the practice of annual FHA insurance activity authorizations, but no longer set dollar limits.

MBA believes that reductions in Federal spending are necessary in order to decrease interest rates and restore investor confidence. The FHA mortgage insurance and GNMA-MBS programs, however, rely solely on private investment funds. There are no Federal dollars expended under these programs. Nor are there any ties to the Federal Financing Bank (FFB), as the private lender, not the Federal government, is responsible for marketing the GNMA securities to investors through Wall Street dealers. To have any impact whatsoever on financial markets, reductions in Federal spending must be real ones, not simply artificial reductions on paper. Proposed reductions in the FHA mortgage insurance and GNMA-MBS guaranty commitment levels will not have an ameliorative effect on interest rates and on the financial market unless marginally qualified home mortgage borrowers are rationed out of the markets because they are unable to obtain mortgage financing at all. Even then, if mortgage credit is reduced and Federal deficit spending soaks up that reduced share, there would be no reduction of interest rates, generally.

Thus, the real issues involved in these proposed reductions are whether the Federal government intends to reduce its commitment to housing and mortgage finance, by restricting programs that enhance the availability of adequate supplies of mortgage credit, especially for moderate- and middle-income families and first-time homebuyers, and whether these reductions signal an intent to reduce, overall, the share of credit that has historically been utilized in financing mortgages. These issues are being addressed at a time when the potential, albeit frustrated demand for home mortgage credit has never been stronger.

The Federal government, long ago, recognized the social need for, and importance of, housing its citizens, and responded in an appropriate manner by creating programs to fulfill this social goal. Not only have the non-subsidized FHA programs and the GNMA-MBS program worked efficiently by not incurring any costs that drained revenues, but they have been profitable and achieved a remarkable success in structuring a mortgage finance delivery system that provides readily available sources of mortgage credit throughout all phases of interest rate cycles, and involves private sector lenders and investors to a maximum degree.

The real benefit enjoyed under these programs is not a subsidy, but the capital market efficiency of the GNMA security, and the standardization offered by the underlying FHA and VA loan instruments. The non-subsidized FHA mortgage insurance program, has created an atmosphere encouraging a continued source of private mortgage credit for low-downpayment, fixed-rate loans to homebuyers. The GNMA-MBS program ensures lenders of ready placement in the secondary market for FHA and VA loans. In effect, the existence of the GNMA-MBS program allows the individual consumer the same access to the credit markets as large corporate borrowers and the government (see subsequent table on page 17).

The future of the mortgage finance delivery system is heavily clouded by uncertainty. The thrift industry is undergoing unprecedented difficulties, which undermine its capacity to provide long-term financing for homebuyers. Fundamental changes in the future powers of all financial institutions are presently being debated in Congress, and those changes will undoubtedly alter the roles of many institutions that previously have been deeply involved in mortgage finance. As the role of these traditional mortgage finance institutions as a predominant source of mortgage credit is altered, the pivotal importance of the secondary mortgage market will increase, because of its ability to attract supplies of mortgage credit from non-traditional, as well as traditional, investors. A lender, rather than having to procure an investor for every individual loan, now packages a number of loans in a mortgage pool, which is a more efficient process and less costly. Investors need not consider the merits of the individual loans themselves, or even know anything about mortgages, but rely instead on the proven track record of the GNMA security.

Not only is the role of primary lending undergoing radical changes, but the very nature of the mortgage, itself, is being altered. With the inflationary atmosphere and volatile interest rates of the recent past, investors are less willing to lock their funds into long-term fixed-rate instruments. The proliferation of creative mortgage financing techniques has precluded standardization of the underlying mortgage instruments—a feature that is essential whenever loans are to be pooled and sold in volume to back securities in the secondary mortgage market.

The GNMA-MBS is one of the most significant and successful mechanisms ever derived for attracting capital for mortgage investments. MBA believes that the continued strength of the GNMA-MBS program will assist rather than impede the development of a viable conventional MBS market, because trading in the GNMA-MBS serves to establish a benchmark for the pricing of these instruments, as well as serving as a model for the development of a conventional MBS in a market that is currently undergoing radical changes. These fundamental changes inhibit the standardization that is so necessary to investor acceptance of these types of instruments, and may retard the development of an acceptable conventional MBS format.

In summary, the actuarially sound FHA mortgage insurance programs and the GNMA-MBS guaranty program were created to foster support for homeownership and assure access to the credit markets. These programs are remarkably successful at achieving these goals, at no cost to the Treasury. However, the task is not yet finished. The 1980s represent a clear challenge to the housing and mortgage finance industries to deliver adequate supplies of affordable mortgage credit to unprecedented numbers of potential homeowners. The FHA and GNMA-MBS programs will help to address those needs efficiently, unless credit budget ceilings restrict their operations. This Congress will make the decision whether this Nation's commitment to housing its citizens remains one of its important goals.

FEDERAL HOUSING ADMINISTRATION

In 1934, FHA initiated the concept of the amortized, level-payment home mortgage loan backed by mortgage insurance in the event of default. Prior to the development of the mortgage insurance concept, mortgage lenders had required large downpayments to secure the property and balance the risk, and demanded lump sum "balloon" payments at specified, short-term intervals. FHA, by pooling the risks of any individual loan across a large group of loans, was able to reduce the potential cost of risk-taking with mortgage insurance. MBA strongly supports the role of FHA, which, in a working partnership between the government and private enterprise, has successfully delivered housing and mortgage finance to American families for nearly fifty years.

FHA became successful while, at the same time, not draining Federal resources by involving the private sector to the largest extent possible. It is the private lender who provides the mortgage funds to the borrower, while the loan is insured for a fee by FHA. The government becomes involved only if the borrower defaults on the loan, in which case the lender is reimbursed for losses from reserve funds that are sustained completely by monthly insurance premiums, that is, user-fees paid by borrowers (see Exhibit 1). These user fees also pay all administrative expenses connected with the non-subsidized mortgage insurance programs, including salaries, rent, overhead, etc.

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

GNMA was established in 1968, and its Mortgage-Backed Security (MBS) program was initiated soon after to introduce alternative sources of capital investment into the secondary mortgage markets. Lenders, who originate mortgages, increasingly have sold these loans through the secondary market to permanent investors, rather than holding the mortgages themselves as long-term portfolio investments. This allows lenders in credit short areas to place their loans in the long-term capital markets, so that the lenders can reinvest their limited capital in additional local mortgages. Mortgage finance now depends upon accessibility to an efficient nationwide secondary market. GNMA's MBS program has helped to foster the secondary market and mobilize money on a nationwide basis, while providing the necessary assurance for investment in mortgages. This instrument has served to stabilize the mortgage finance market throughout economic cycles, as well as to create a truly nationwide secondary market.

The creation of the GNMA-MBS revolutionized mortgage finance by providing a highly liquid, securitized instrument, which attracted traditional and non-traditional investors alike, as illustrated by the following:

Table 2

Distribution of Holdings of GNMA Securities
(dollars in billions)

INVESTORS GROUPS		INVESTORS GROUPS	
Mutual Savings Banks	$ 11.5	Corporations/Parnerships	$ 7.8
Commercial Banks	6.4	Private Individuals	2.5
Savings & Loan Assoc's	22.8	Credit Unions	2.3
Public Retirement/Pension Funds	11.3	Life Insurance Companies	3.4
Private Retirement/Pension Funds	.3	Other Insurance Companies	.5
Mortgage Bankers	3.0	State & Local Govt. Gen. Funds	5.7
Securities Brokers/Dealers	5.7	Fiduciary - Individual	.6
Nominees	40.9	Fiduciary - Institutional	.9
		Others	.4
		TOTAL	$ 126.0
		Terminated Issues	1.2
		TOTAL ISSUES	$ 127.2

Source: Prepared by the Office of the Secretary, GNMA, January 13, 1982.

The GNMA-MBS program primarily involves FHA and VA but not conventional loans. Under the MBS program, lenders package FHA/VA mortgages into "pools" and sell them in the capital markets to permanent investors. GNMA prescribes a standard format for the securities and guarantees the performance of the originator/issuer, who must pay investors in full each month, regardless of whether all funds have been received from homeowners. Although the GNMA-MBS is a guaranty program, in the 11 years of its existence, its fee income has always offset its expenses. It has not cost the government a single penny (see Exhibit 2). Additionally, it is a secondary guaranty program. Therefore, a reduction in the program's commitment ceiling would not result in a decrease in the overall supply of credit, unless, and only to the extent that a GNMA commitment ceiling would restrict guaranty loan program activity in the underlying primary programs—the FHA insurance and VA guaranty programs.

The GNMA-MBS program does not involve a subsidy to either borrowers, lenders, or investors. Rather, by pooling individualized loans and guaranteeing the pool payments, it simply allows the individual borrower the same access to the capital markets as large corporate or governmental borrowers. Table 3 compares the secondary market yield of GNMA securities with long-term corporate and utility bonds. The comparison reveals that the yields on these various investments are on a roughly equivalent plane for the nine year period covered. In fact, the yield on a GNMA security has, on average, been 26 basis points (26/100ths of 1 percent) higher than comparable corporate bonds and 32 basis points higher than "AAA" rated utility bonds of a similar maturity. Thus, the GNMA-MBS program ensures that the credit market is open to the homebuyer on a similar basis as that of large corporations.

Table 3
Market Yields On Long-Term Securities

Year	GNMA Securities[1]	Corporate Bonds[2]	Utility Bonds AAA Rated[3]
1972	7.59	7.59	7.31
1973	8.28	7.89	7.74
1974	9.34	9.42	9.33
1975	9.12	9.51	9.39
1976	8.74	8.59	8.4[illegible]
1977	8.55	8.20	8.19
1978	9.52	8.20	8.19
1979	10.79	10.05	10.03
1980	13.14	12.77	12.74
1981	15.94	15.47	15.56

1. Secondary market yield on GNMA securities plus 0.5 percent paid to GNMA by the issuer of the security (and collected from the borrower) as a fee for servicing and processing.
2. Corporate bond yield, new issues rated Aa, as reported monthly in Business Conditions Digest, Department of Commerce.
3. Utility bond yield, new issues rated AAA, as reported monthly in the Federal Reserve Bulletin, Federal Reserve Board of Governors.

Limitations on the GNMA-MBS program constitute a backdoor approach to restricting not only the FHA programs, but also the VA guaranty program, which is an entitlement program. On average, over 80 percent of single-family FHA loans and over 70 percent of single-family VA loans have been placed in GNMA-MBS pools over the past five years. Should a restrictive GNMA-MBS activity ceiling be approached, lenders originating FHA-insured and VA-guaranteed loans would be forced to discontinue originations for lack of a currently available or foreseeable market under the GNMA-MBS program. GNMA's role is even more important, because thrift institutions are decreasing their level of activity as portfolio lenders. Therefore, the secondary mortgage market will continue to increase in importance over the next decade, and will demand the availability not only of the GNMA-MBS program, but of new types of conventional mortgage-backed securities patterned after the GNMA-MBS program.

CREDIT BUDGET ESTIMATES

In its calculations justifying deep cuts in the FHA and GNMA-MBS programs, OMB has used the "gross" commitment levels to support their claims that these programs soak up too large a share of credit. This is misleading and overstates the involvement these programs represent. The gross commitment figures for these two programs are not reliable indicators of actual FHA insurance written and GNMA guaranties issued. There is significant "fallout" in these programs between the commitment stage and the point when FHA insurance is written or GNMA guarantees are issued.

The reason for the wide disparity between commitments and final insurance and guarantees is that these programs are designed to operate flexibly as "market hedges" for borrowers, builders, and lenders. If no other form of mortgage insurance or no other secondary market placement is available, or is available but only on less preferable terms or rates, then a borrower or lender may opt to use the FHA or GNMA-MBS programs, and only then is final insurance written or securities are issued. These commitments, however, are available to the borrower, builder, or lender, in the event they are needed and help to keep these markets functioning when other credit sources are unavailable. Thus, the current method of operation creates a situation where FHA is primarily used as a last resort for mortgage credit.

Additionally, it should be noted that the figure for GNMA guaranties issued reflects secondary rather than primary guaranty activity. GNMA-MBSs are backed by pools of FHA and VA mortgages. Thus, the dollar volume figure for GNMA-MBSs does not effectively represent additional contingent liabilities for the Federal government, nor does it represent additional Federal activity in the Nation's credit markets above and beyond the totals for FHA-VA loans. The alarms that are being sounded about the Federal Government's overwhelming exposure in the area of mortgage finance are substantially overstating that involvement.

MBA is concerned that the ceilings Congress sets, even if they are established at the limits of projected demand, nonetheless may prove insufficient. In a review of the OMB budget estimates over the past eight years, which are estimated two years in advance of the actual fiscal year, it is evident that these estimates consistently have been understated. This points out the virtual impossibility of accurately trying to estimate interest rates, housing activity, and the possibility of increased FHA mortgage limits accurately two years in advance.

Table 4 tracks gross and net commitments, estimated and actual, for the FHA-insured programs and the GNMA-MBS program over the past eight years, and illustrates the uncertainty in this process:

Table 4

LOAN GUARANTEE COMMITMENTS AND LOANS GUARANTEED

(in millions of dollars)

Fiscal Year	Gross FHA Commitments	Net FHA Guaranteed	Gross GNMA Commitments	Net GNMA Issuances
FY 1981 Actual	23,634	17,741	42,150	16,853
FY 1982 BUDGET				
1982 Estimate	44,284	31,840	72,360	31,360
1981 Re-estimate	39,232	25,911	72,000	31,000
1980 Actual	30,585	23,344	63,165	22,996
FY 1981 BUDGET				
1981 Estimate	34,155	24,288	53,000	25,000
1980 Re-estimate	31,514	21,695	47,200	20,500
1979 Actual	33,976	21,081	41,750	22,176
FY 1980 BUDGET				
1980 Estimate	27,705	18,601	16,500	16,500
1979 Re-estimate	24,656	16,450	15,000	15,000
1978 Actual	23,953	14,292	15,194	15,194
FY1979 BUDGET				
1979 Estimate	24,709	18,231	15,500	15,500
1978 Re-estimate	20,262	13,384	16,000	16,000
1977 Actual	19,776	12,929	17,019	17,019
FY 1978 BUDGET				
1978 Estimate	16,095	16,095	10,000	10,000
1977 Re-estimate	11,594	11,594	10,000	10,000
1976 Actual	8,316	8,316	8,999	8,999
FY 1977 BUDGET				
1977 Estimate	15,161	4,905	10,000	10,000
1976 Re-estimate	12,056	6,436	10,000	10,000
1975 Actual	11,221	6,130	5,905	5,905
FY 1976 BUDGET				
1976 Estimate	6,093	7,731	7,500	7,500
1975 Re-estimate	5,102	5,663	5,100	5,100
1974 Actual	5,638	5,712	4,125	4,125

Source: Special Analysis, Federal Budget

ACCESS TO CAPITAL MARKETS

While private mortgage insurance is available for conventional mortgages at all times, the history of the conventional mortgage market is replete with cycles of high cost and reduced availability of mortgage funds, due in large part to its dependence on thrift institutions. The situation in early 1982 illustrates the cyclical problems of the conventional mortgage market in a terribly clear manner. Lack of readily available conventional financing historically has forced many borrowers into the FHA market on a last resort basis. FHA lending has not suffered as heavily at such times, because of the availability of the GNMA-MBS, which is familiar to and accepted by investors. The FHA and GNMA-MBS programs operate, especially during such times, as a backstop for lenders and builders, who must operate in all economic cycles in order to survive financially. Thus it also operates as a backstop for homebuyers. As other private and quasi-governmental institutions develop their respective conventional MBS programs, it is almost certain that the GNMA-MBS program, which has in many respects served as the model for development of securities to tap the capital markets for mortgage finance, will naturally diminish in importance. But this development will take time, and must occur naturally in order to avoid market disruptions.

Both the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) are vigorously implementing new conventional MBS programs. FNMA recently announced its new conventional MBS program. Also, legislation has been introduced (HR 4787 and S 1805), which would authorize the FHLMC to alter its operations to pattern itself after the GNMA-MBS program, with an orientation toward the conventional market. These are long-sought and welcome developments, but there remain a number of problems to resolve in this area.

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The privately marketed conventional MBS issuances are a relatively recent innovation, having had a mortgage pool balance of only $1.1 billion at the end of 1978. By the end of 1981's third quarter, the outstanding balance of such pools had grown to over $13 billion, as compared with $104 billion of GNMA-MBS securities outstanding as of the end of 1981. However, the development of these instruments is a complicated process that will require years of evolution and cannot be forced by legislative, regulatory, or administrative mandate.

An important impediment to private issuance of mortgage-backed securities has been the lack of significant mortgage volume, because of high interest rates and lack of standardization in the underlying mortgages. Thus, conventional mortgages have been denied access to the capital markets, and therefore liquidity, which is the major benefit of an MBS instrument. The limited marketing that has taken place has been via private placements. This means that the lender must secure an individual investor on a case-by-case basis. This situation can only be cured when interest rates recede and market experimentation abates. Standardization of conventional securities depends upon origination of a large dollar volume of loans with similar characteristics regarding dollar amount, interest rate, terms, etc. However, the conventional mortgage market today is characterized more by its heterogeneity than its homogeneity. The push toward development of creative financing techniques has fragmented the mortgage market, and this lack of standardization impedes the further development of the conventional MBS instrument. Undoubtedly, these problems will be addressed and resolved over time, as lenders and borrowers choose what types of financing best serve their respective needs. But, an extended experimentation period must occur before a conventional MBS program will be developed to address the entire market.

A necessary requirement for the development of an efficient nationwide market in conventional MBS issuances is that the market be large. Security dealers typically "make the market" in various types of securities. In order for security dealers to incur the necessary start-up costs for developing a market, they must be assured that there will be enough volume in that security to warrant their investment. If the market is relatively small, which occurs when each security possesses different features, the dealers either will not develop the market, or will impose large and possibly prohibitive transaction costs. Therefore, the development of the conventional MBS market is not being delayed because of the growth and success of the GNMA-MBS program, but is being restricted due to the lack of uniformity in the underlying conventional loan market itself. In fact, the existence of the GNMA security program makes it more likely that the conventional mortgage-backed security market eventually will develop. As the President's Housing Commission recently observed, "The current GNMA market has substantial depth and liquidity, a goal which may not be achieved by conventional pass-through markets for several years. Moreover, the GNMA market may well play a supportive role in the development of the conventional mortgage-backed securities (CMBS) markets. GNMA securities serve as a benchmark against which new types of mortgage-backed securities can be priced. GNMAs also provide the basis for the prospective exchange-traded options market and the currently active organized futures markets in GNMAs. These markets allow mortgage originators and investors to hedge their interest rate risks. Moreover, the futures markets permit hedging activities necessary to the development of dealer forward markets for CMBSs. Forward markets are important to issuers of pass-through securities, and dealers that issue forward purchase commitments often utilize GNMA futures to cover their positions."

Currently, the conventional mortgage market is in disarray. Large numbers of thrifts are operating in the red because they must pay savers high short-term rates, while their incomes are dependent on old below-market rate mortgages held as assets. As a result, the thrift industry is focusing on the design of new mortgage instruments that will fluctuate with its costs of funds. Thrifts are also diversifying their portfolios by increasing their holdings of assets bearing shorter maturities and selling their new mortgages to investors. However, competition from Treasury debt and inflationary expectations limit the willingness of investors to buy these mortgages.

CYCLICALITY: THE ROLE OF FHA AND GNMA

Until conventional lenders solve their problems, or the secondary market institutions, including FHLMC and FNMA, as well as others, are able to expand their capabilities, it is sophistic to argue that mortgage insurance companies can absorb the FHA activity. The difficulty does not lie with the financial capacity of the mortgage insurance companies—they are able to deliver their product—but they are insurers, not lenders. Conventional lenders and conventional secondary market investors are currently encountering such difficulties that they are unable to provide an affordable, steady stream of mortgage funds.

It is precisely this continuing cyclical instability of the conventional market that underscores the necessity of preserving the FHA and GNMA-MBS as demand programs, until these problems are resolved. The FHA non-subsidized programs, with the readily available secondary backing of the GNMA-MBS program, serve a vital countercyclical purpose during economic downturns.

As the following table illustrates, the FHA percentage share of the insured mortgage markets has been relatively high during economic downturns (1974-75 and 1979-81) while it has naturally contracted during stronger housing years:

Table 5

CONVENTIONAL LOANS INSURED BY MORTGAGE INSURANCE COMPANIES (MIC), FHA AND VA INSURED AND GUARANTEED LOANS BY UNIT VOLUME/1-4 FAMILY HOUSING

Year	Conventional MIC	FHA* New	FHA* Existing	FHA* Total	VA	Total Loans Insured	FHA as % of Total
1970	59,384	55,580	247,798	303,378	167,380	530,142	57
1971	163,334	59,133	277,654	336,787	282,145	782,266	43
1972	396,008	58,393	178,323	236,716	353,761	986,485	24
1973	499,895	28,940	109,740	138,680	304,788	943,363	15
1974**	**330,646**	**22,559**	**130,300**	**152,859**	**305,314**	**788,819**	**19**
1975**	**322,204**	**35,946**	**192,594**	**228,540**	**293,594**	**844,358**	**27**
1976	450,810	32,128	200,230	232,358	321,586	1,004,754	23
1977	617,398	42,786	246,386	289,172	371,610	1,278,180	22
1978	695,620	40,409	263,056	303,465	352,797	1,351,882	22
1979**	**578,111**	**62,960**	**368,013**	**430,973**	**345,708**	**1,354,792**	**32**
1980**	**392,808**	**58,964**	**289,450**	**348,414**	**255,631**	**966,853**	**35**
1981**	**268,522p**	**30,981p**	**130,687p**	**161,668p**	**118,842p**	**549,032**	**29**

*Includes: Sec. 203(b), 234, 244, and 245 (GPM)

**Boldface indicates periods of restricted mortgage credit.

p - Preliminary, 1st 9 months.

Source: HUD, 1979 Statistical Yearbook, Survey of Private Mortgage Insurance Activity, FHA Monthly Report of Operations, Veterans Administration. Prepared by the Mortgage Bankers Association of America, April 1981.

Table 5 also illustrates the growing share of the insured mortgage market that conventional mortgage insurers have pursued and won. But this long term trend contrasts sharply with experience during the last three years, when conventional lenders sharply curtailed lending, in part because the conventional secondary market was unable to accommodate further growth.

MBA believes that the current problems facing the conventional mortgage market can and will be sorted out over the next decade. MBA is working aggressively with other lenders and with the mortgage insurance industry to develop a conventional MBS instrument. New alternative mortgage instruments acceptable to the secondary market will be developed, as will a conventional MBS capable of delivering mortgage finance at affordable rates.

The institution of a restrictive credit budget on mortgage finance programs will seriously deter this Nation from continuing to meet its commitment to provide an adequate supply of affordable housing. MBA believes that the imposition of limitations on the FHA and GNMA-MBS programs will not help to achieve the goal of efficiently coordinating the Government's resource allocation with its fiscal policies and direct expenditures, but rather will only serve to decrease the opportunity for, and affordability of, homeownership.

RESCISSION AND BUDGET PROPOSALS FOR MULTIFAMILY ASSISTED HOUSING PROGRAMS

The multifamily housing industry has been operating under the impression that the Administration was committed to funding the current 'pipeline' of multifamily housing projects. Department of Housing and Urban Development Secretary Samuel Pierce, along with many Congressional leaders, have, throughout the past year, announced such a commitment and promised efforts that would enable these pipeline projects to proceed. Based on those promises, developers in good faith have invested millions of dollars to keep their projects alive during the last year awaiting an improved market. They currently face huge losses because they relied on such commitments to the pipeline.

Now the Administration has concluded that the Section 8 Leased Housing Assistance Program is too costly and should be discontinued after FY 1982. The FY 1983 budget proposal calls for rescission of FY 1982 Section 8 budget authority that represents the loss of over 75,000 Section 8 units for which funds have been committed.

In addition, certain regulatory actions will curtail activity even for those pipeline projects that otherwise would be funded. An example of the regulatory actions being taken by HUD, which have the effect of impoundment, is the imposition of a 7.75 percent per annum cap on Section 8 contract authority increases. Many projects have been in the pipeline for several years, over which time double-digit inflation has meant that the rent expenses originally calculated for the projects would receive a lesser mortgage amount than is needed to run the project without an operating deficit. Congress should be aware that the greater increase is needed not because of cost overruns in building the projects—these projects have not yet begun construction. The increase is needed to get the projects started at a feasible level. To reiterate the point, this 7.75 percent limitation is, in effect, an impoundment of Section 8 funds because, with its imposition, projects are infeasible, and therefore, cannot go forward. If they did go forward, the operating shortfall would continue throughout the life of the project.

In November 1981, the Financing Adjustment Factor (FAF) became effective after months of negotiations among HUD, OMB, the Congress, and industry groups. A recognition by the Congress that a financing adjustment procedure was necessary to facilitate new construction of Section 8 assisted housing was instrumental in getting FAF implemented. High interest rates coupled with limitations on rents made the production of many units for which funds had been set aside during FY 1979, 1980, and 1981 infeasible. The FAF was supposed to provide relief to those projects and to allow the continued processing of Section 8 projects without interruptions due to fluctuations in the financing markets. FAF became a reality only after a bipartisan coalition of 78 members of Congress made their support of FAF known to OMB Director David Stockman.

Market conditions, however, have not allowed the FAF to work under the procedures established for it by HUD and OMB. To date, the industry can only identify three projects that have closed using the FAF. Two of the main problems with the FAF are the 12 percent cap set on FAF interest rates and the requirement that construction must begin on FAF projects by June 1, 1982. The 12 percent cap is a problem because current tax-exempt market rates are near 14 percent. Due to the length of time taken to finally get the FAF regulations finally in place, coupled with the harsh weather this winter, it will be most difficult for projects to start construction by June 1.

MBA urges Congress' support in encouraging both HUD and OMB to redesign the FAF so that, in fact, it is a workable tool that can be used to fund the current pipeline of tax-exempt Section 8 projects.

The above-mentioned problems have all dealt with funding the present pipeline of multifamily projects. Also of concern to the industry is the future of multifamily rental production. Without the Section 8 new construction and substantial rehabilitation program there will remain no workable production vehicle for multifamily housing. Several trade associations in Washington have been developing a multifamily production program designed to produce 100,000 units of new and rehabilitated rental units of modest design for moderate-income families. The rationale of this program is to increase the present stock of rental housing, a goal that will not met by the housing voucher program as proposed by the Administration.

Representative Gonzolez has introduced a bill, HR 5731, which contains a rental housing assistance initiative that would support 100,000 units. This program has been designed as a relatively inexpensive program with low actual yearly expenditures. The assistance would be in the form of a loan to pay part of the mortgage interest to the developer and would be advanced monthly for a 15-year period. The interest loans would be secured by a second mortgage on the property and would be repaid.

MBA would like to encourage support for the concept of a Federal program for the production of rental housing. Without government intervention, the private marketplace simply cannot serve the shelter needs of those unable to be homeowners. MBA urges your support in the efforts to develop such a program that could most efficiently be administered by HUD through the FHA-insured loan programs for multifamily housing.

MBA would like to thank the Committee for providing the opportunity to express our views on these vital issues. We should be pleased to provide additional details for the record.

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EXHIBIT 1

MUTUAL MORTGAGE INSURANCE FUND INCOME STATEMENT: 1950-1980

(Millions of Dollars)

	ANNUAL AVERAGE FOR 5-YEAR PERIODS ENDING:							FISCAL YEARS ENDING:		
	6/55	6/60	6/65	6/70	9/75(1)	9/76	9/77	9/78	9/79	9/80
Fee Revenue	12.0	15.2	21.3	25.5	23.3	21.0	26.4	29.5	33.5	13.6
Premium Revenue	45.8	85.3	153.1	219.0	264.8	245.0	251.8	267.0	299.8	347.0
Investment Revenue	5.3	10.9	18.8	29.6	88.8	116.7	123.8	136.7	147.3	160.8
Other Revenue	.4	.4	12.5	-1.0	.5	-1.1	2.5	5.9	7.4	14.2
Total Revenue	63.5	111.8	205.7	273.1	377.5	381.7	404.4	439.1	487.9	535.6
Salaries and Expenses	22.2	35.4	55.1	66.5	93.9	110.9	107.7	112.1	117.0	125.1
Interest on Debentures	.4	-.1	17.8	3.5	.3	.2	.2	.2	.2	.2
Loss on Acquired Properties	.1	.9	49.2	92.5	124.3	139.2	123.7	96.5	118.1	81.0
Other Expense	.3	.0	.3	8.5	4.5	11.3	20.1	23.8	28.2	26.8
Total Expense	23.1	36.2	122.4	171.0	223.0	261.7	251.7	232.6	263.4	227.1
Net Before Allowances	40.4	75.6	83.3	102.1	154.5	120.0	152.7	206.5	224.5	308.5
Valuation Allowances	-.2	-2.7	-15.8	7.3	-24.6	21.3	-.1	-18.5	-21.1	-71.1
Net Income	40.3	72.9	67.5	109.3	129.9	141.3	152.6	188.0	203.4	237.4

NOTE (1) Includes Transitional Quarter 7/75-9/75

Source: Derived from HUD published data, March 1981.

EXHIBIT 2

FINANCIAL SUMMARY OF MBS OPERATIONS AND RETAINED EARNINGS

FISCAL YEAR

(Dollars in Thousands)

	1970	1971	1972	1973	1974	1975	1976[a/]	1977	1978	1979	1980
Income											
Guarantee Fees	$ 13	$ 829	$2,602	$4,529	$ 6,984	$ 9,705	$18,336	$23,432	$ 32,180	$ 41,132	$ 55,730
Commitment Fees	45	431	426	376	781	1,440	3,254	3,961	3,434	51,32	5,041
Interest Income	-	4	108	340	814	1,518	2,996	3,909	5,897	9,853	16,955
Other	-	1	75	84	104	157	313	605	794	1,095	1,824
Subtotal	58	1,265	3,211	5,329	8,683	12,820	24,899	31,907	42,305	57,212	79,550
Expense											
Operating Expense	89	315	438	513	602	856	1,303	1,382	2,102	2,435	3,046
Guaranty claims	-	-	-	-	352	686	4,734	1,584	1,200	393	1,146
Subtotal	89	315	438	513	954	1,542	6,038	2,966	3,302	2,828	4,194
Net income,	-32	950	2,773	4,816	7,730	11,278	18,862	28,940	39,003	54,385	75,357
Adjustments to prior year net income[b/]	-	-	-	-	-	-	+240	-	-116	+72	-915
Net Worth/Retained Earnings[c/]	-32	918	3,691	8,507	16,237	27,545	46,617	75,557	114,444	168,901	243,343

Totals may not add due to rounding.

[a/] Fifteen month fiscal period includes period from 7/1/76 to 9/30/76 and results from change in government fiscal year.

[b/] Includes $880 thousand of advances written off as uncollectable in 1980. The other amounts represent adjustments to costs incurred in previous periods under the contract with FNMA.

[c/] Equals cumulative net income.

Note: Advances to defaulted issuers, and repayments of the same, do not flow through expense accounts since they represent a charge against capital. They are presented below for informational purposes.

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	1980
Advances	-	-	6	-	66	717	1,466	9,111	5,178	653	4,674
Repaid & Write Offs	-	-	-	-	-	-135	-337	-2,923	-6,492	-4,026	-3,055
Outstanding Balance	-	-	6	6	72	654	1,783	7,971	6,659	3,284	4,903

Source: Derived from HUD published data, March 1981.

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Statement of

JAY JANIS, President

California Federal Savings and Loan Association

to the Senate Budget Committee

March 11, 1982

Mr. Chairman and distinguished members of this Committee:

I especially welcome this opportunity to appear before you because I am so deeply concerned about the state of housing in our nation.

This is undoubtedly the worst housing crisis this nation has experienced since World War II. What is especially disturbing is that housing -- as a national goal -- is no longer high on the list of America's priorities. Ironically, this has happened more by oversight and omission rather than by direct action on the part of our political leadership. Moreover, the people of this country have had no say in that decision to relegate housing to a secondary role. The decision that affected housing so adversely was made by Congress in 1980 -- perhaps unknowingly -- when they determined to pay savers a competitive, market rate on their deposits. It followed, inexorably, that borrowers would have to pay a market rate for mortgage credit. The hope was that the general level of interest rates would remain low enough so that mortgages could be made at affordable - albeit higher - rates. Congressional strategists reasoned that short term rates would rise only for short periods of time, and that by allowing depository institutions to pay competitive rates, disintermediation could be avoided. Well, they guessed wrong. Short term rates and, of course, long term rates have remained high, persistently, as a result of inflationary expectations which were essentially relating to the lack of a clear economic policy. Those persistently high rates meant that the average American home buyer had to compete with large corporations and the U.S. Treasury for funds, and that turned out to be simply no contest. The home buyer could not pay those high rates, and home building has been sharply curtailed ever since.

Mr. Janis is the former Chairman of the Federal Home Loan Bank Board and was Under Secretary of the U.S. Department of Housing and Urban Development.

My background -- as a former builder and former government official in the housing arena and now president of the nation's largest mutually-owned savings and loan association in America -- has taken me through six postwar credit crunches or economic cycles.

But this credit crunch is different from the others:

In the past, the problem was an absolute shortage of credit which caused high rates. This time credit is available, but rates are still high. That means that inflationary expectations are driving up interest rates; in other words, supply and demand are not working in the normal manner relative to price. And this time, interest rates are persistently higher than in the past.

In the past, a recession brought about lower interest rates, but this time the recession has not had that effect. Moreover, the historically reliable "countercycle" relationship of housing to the economy is not working. Nor has tight monetary policy proven to be the answer. Nor moderate wage demands from labor unions. Not even an oil glut seems to be helping.

In this credit cycle, other industries are feeling the pinch along with housing. This includes automobiles, airlines, farm equipment, entertainment, and credit sensitive small businesses.

In this credit crunch, the normal self-correcting pendulum is simply not working in the usual way.

Obviously, this crunch is qualitatively and structurally different, and the effects and impact on housing seem to be much greater: more builders are going out of business; more savings and loans are being merged out of business; more deflation of housing prices is taking place; and more uses of creative financing is being made, the effects of which may someday come back to haunt us.

All of this is occurring at the worst possible time for housing: there are severe reductions in federal efforts to provide housing for low and moderate income families; state and local government budgets are being pinched more than ever as a result of local initiatives such as Proposition 13, Proposition 2½, and now the "New Federalism", and the demand for housing because of the baby boom is at extraordinarily high levels.

There is a simple-minded syllogism that many people have adopted. It goes something like this:

1. High interest rates are causing the housing crisis.

2. High interest rates are caused by big federal deficits.

3. Therefore, reduce federal deficits and you will end the housing crisis.

I challenge the validity of this syllogism. Agreed, high interest rates are the root cause of the housing crisis; but the answer to high interest rates is not necessarily a balanced budget or reduced deficits. Surely, that will help. But if the culprit is truly inflationary expectations, then what we need is a comprehensive, anti-inflationary economic strategy which meshes fiscal and monetary policy, productivity increases in industry, higher savings rates, energy conservation programs, and careful deregulation of certain industries.

Part of the strategy, of course, involves achieving lowering the deficit. But all of the reductions in spending do not necessarily have to come from domestic programs generally, or from housing in particular. Defense cannot be considered a sacred cow forever. High defense expenditures severely affect inflation in terms of the drain on manpower and materials. Someone simply has to begin to tell the truth about the defense budget. It is not a matter of being weaker or stronger than the Russians. Obviously, we must have a strong national defense, but the considerable efforts expended in finding waste, fraud and abuse in the health and social services programs should be matched in the defense area. That is where I believe real savings can be found.

It is important that the ideology of free markets not take the place of pragmatism. Perhaps some government intervention to help housing and the savings and loan industry does make sense. Perhaps it will be cheaper for that intervention to take place now rather than later when the costs will be much higher. Perhaps some steering of credit -- some kind of credit allocation to socially-useful purposes -- makes sense but only as a last resort and only if nothing else is done to mitigate our housing problems. The value of housing must be weighed -- not against durable goods such as autos and refrigerators -- but in other terms as well.

For instance, take the economic effects of housing. This means jobs to build the housing; jobs to manufacture the building materials and the appliances; and jobs to produce the products for the completed home -- furniture, drapes, carpets, etc.

Look also at the social impact of inadequate housing: the effect on the health and welfare of our citizens; the effect on family life; the effect on family formation and the delay our children will have in putting down their roots; and the effect on the mobility of our citizens and the loss of personal freedom, which is unacceptable in a democracy.

Politically, housing is also important because a housing crisis threatens the American dream and the American way of life.

But these are generalities. Let's look at the specifics of what is going on in the real world of housing.

Sit in most any savings and loan association at a typical meeting of its loan committee. Some money is available, but few deals are being presented. Potential buyers simply can't qualify for 16.5 or 17 percent mortgages. No wonder that S&L lending is off some 70 to 80 percent from 1979 peaks. When deals do come in, often two or more families are applying for the same loan on the same house. Doubling up is clearly occurring.

Or take the typical realtor. In his or her case plenty of deals could be made if only the financing could be handled. The few deals that do close usually involve balloon payments; interim financing devices; second, third and fourth mortgages; loans due in three or five years; steep buy-downs; and so forth.

And what about the typical builder? He is sitting on a frightening amount of unsold inventory, paying interest on a construction loan at prime plus two percent or more. And that construction loan interest rate is bumped to prime plus four percent if he is delinquent. He is running out of resources and the ability to hold on.

Most important, what about the typical buyer? He's paying 45 or 50 percent of income and is getting less house, if he can qualify for a house at all. And then he is taking a chance on his ability to refinance in a few years.

That brings up an interesting question. What will happen when these short-range financing techniques come home to roost? What happens in, say, 1984 when the real estate financing of 1979 and 1980 must be refinanced -- at the same time that corporations and state and local governments must refinance and at the same time that defense expenditures will be at their highest? We may be heading for a massive credit crunch relatively soon, and given the market rates that home buyers must pay, there will be precious little credit available for housing.

SOLUTIONS

Of course, everyone is searching for answers to the housing problem in our nation. Some people in leadership positions say to their experts: "Go out and find me an answer, but make sure it doesn't cost any money." This is because they believe that any spending means bigger deficits which, in turn, means continued high rates. I challenge such an approach which restricts solutions to those that don't cost money. There are other choices.

(In fact, there must be other choices because housing has borne too great a burden in the last few years. Housing starts at a 1.0 to 1.1 million level are not acceptable in the light of numerous studies which show this nation requires 2.2 to 2.4 million new units per year to meet our housing needs.)

One choice is to develop a truly comprehensive anti-inflation program with all of the elements I have discussed earlier: a monetary and fiscal policy that meshes; incentives for increased industrial productivity and incentives for savings; a national energy conservation program; and careful deregulation of certain industries.

But there are other choices as well, and some will save money:

-- find the waste in the defense budget

-- delay the 1982-1983 tax decrease

-- enact the so-called "sin-tax"

Other choices don't cost money and directly help housing:

- -- the Federal government could assure the viability of our financial system both as to capital and liquidity

- -- pension fund lending restrictions could be eased to provide new sources of capital for mortgages

- -- support could be given to Federal credit agencies (FHA, GNMA, etc.) rather than restricting the scope of their activities.

- -- legislation could be enacted to deal with the constraints that unnecessarily raise housing costs: restrictive codes; exclusionary zoning; blind "no growth" statutes; unreasonable permit fees; rent control; and so forth

- -- the Federal Reserve can put pressure on unproductive mergers that sop up credit

- -- Congress could consider mechanisms to steer or allocate credit to useful purposes - but again only as a last resort

And there are other approaches which cost money in the short run but are worth it:

- -- expand existing savings incentive programs (by extending the All

Savers Certificate or creating a new instrument, or both)

- -- take action to make S&Ls viable again as mortgage lenders, perhaps through warehousing their low yielding loans or other devices. This is important because S&Ls are still the major provider of mortgage credit in the nation and because a good part of the housing crisis is due to the flow of funds out of housing's biggest lender

- -- aid elderly and lower income families with special housing programs

- -- assist first time homebuyers to enter the home ownership stream

I rebel against the contention that solutions to our housing problem cannot cost money. This is like saying there will be no solution at all, and none of us should accept that line of thinking.

Congress must once again declare housing to be a high national priority -- as it did in landmark legislation in 1934 and 1937, and after World War II in 1949 and again in 1968. Homeowners must not be forced to pay market rates for money and to compete for credit with large American corporations. This is unfair and unjust. Our democratic way of life requires that the housing crisis facing this nation of ours be resolved -- and be resolved quickly.

National
Democratic
Policy
Committee

Lyndon H. LaRouche, Jr.
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Advisory Council
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No Budget Cuts, No Tax Increases

by Lyndon H. LaRouche, Jr.
Chairman, Advisory Board, NDPC

The following statement was released March 8 by Lyndon H. LaRouche, Jr., Chairman of the Advisory Board of the National Democratic Policy Committee.

This is to announce the reasons why I am now encouraging Democrats throughout the United States to pressure Congress for passage of the Reagan administration's combined budget-proposals and tax-proposals as submitted, and to reject all such foolish schemes as the Baker-Hollings finagling.

The main fact to be stressed is that the United States has already entered the second Great Depression of this century. The depression has not yet become irreversible, although we are presently at the edge of a precipice of chain-reaction bankruptcies of firms, farms and thrift institutions which would create a condition of near-irreversibility.

This depression has been caused by the monetary policies which the Federal Reserve System has imposed on the U.S. economy and world trade since the beginning of October 1979. Unless interest rates are forced down below 10 percent prime rates within weeks, the collapse of the U.S. economy's tax-revenue base will drive the federal deficit toward between $150 and $200 billion for fiscal year 1981-1982 and generate federal deficits "off the charts" for fiscal year 1982-1983.

Obviously, to worry about $10 or $20 billion of combined federal budget cuts and tax-increases under these circumstances is sheer idiocy, as voters will remind candidates for Congress during November 1982.

There is no competent basis for disputing my projections. My associates and I represent the only economic forecasting service whose projections have been competent during the period beginning October 1979. By comparison, every other econometric forecast, including those of the Commerce Department, the Joint Economic Committee of the Congress, and the Office of Management and Budget, have been totally incompetent, less than worthless.

For the Record

For the first half of 1980, my associates and I projected a 6 percent decline in the U.S. economy. The actual decline was 8 percent. No other econometric projections but that of my associates and myself anticipated any significant decline for that period.

In September 1980, we projected a temporary recovery, to last into the first half of 1981, which occurred. In May 1981, we projected a 3 percent decline for the remainder of the year, against an actual 3.4 percent decline for that period. Our present forecast, compiled during February 1982, shows us to have entered a depression, with no recovery in sight even as late as the end of 1983.

These forecasts are based on study of the effects of both the Volcker monetary policy and the Reagan military-spending program on each of all the principal subsectors of the U.S. economy. There can be no recovery from the present slide into a 1932-1933-style economic depression—even with increased military spending—without reducing prime interest-rates below 10 percent levels immediately. After a chain-reaction of bankruptcies among farms, firms and thrift institutions, possibly erupting this spring and summer, even lowering the interest rates will not stimulate any automatic recovery.

The administration and Congress must forget the issue of federal budget-deficits and concentrate all energies on dramatically expanding the federal, state and local tax-revenue base. I have drafted a comprehensive four-point program which will effect the needed economic recovery. Pending the enactment of such a recovery program, the only action which can halt the presently accelerating slide into a Hoover-style depression is a drastic reduction in prime interest rates.

Therefore, although there are many blunders and injustices in the proposed federal budget, improvements in the proposed budget should be deferred to supplementary budget-action over coming months. It is worse than a waste of time to attempt to improve the submitted budget now, an absolutely worthless exercise in legislative theatrics as long as the issue of Paul Volcker and Volcker's economy-wrecking policies is not resolved.

Ladies and gentlemen of the Congress, unless you come to your senses and dump Paul Volcker, the voters of this nation are going to lynch you politically at the polls come primaries and general election this year. Those who fight to rid the nation of the curse of Volcker will earn credit. Those who defend Volcker deserve to be thrown out of office.

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News Release

Four Steps To Get Out Of The New Depression

by Lyndon H. LaRouche, Jr.
Chairman, Advisory Council, NDPC

The simple fact is, about October 1981, the U.S. economy slid into the first phases of an actual depression. A lot of people share the blame for this depression: President Jimmy Carter, who started it back in October 1979; Federal Reserve Chairman Paul A. Volcker, who has directed the collapse; California banker Charles T. Manatt, who mobilized the Democratic National Committee in defense of Volcker; the mis-advisers of President Ronald Reagan, who have engineered a budget deficit in the range of $150 billion; and a very great number of other persons, who rejected foolishly what have proven to be this writer's precisely accurate predictions of the results of foolish "tight-money" policies.

The practical question is not, who is to blame? The practical question is, can we get ourselves out of it? There are four basic, emergency actions which must be taken immediately. Otherwise, without these steps, the present depression will become worse than that of the 1930s. If these four steps are taken, the United States—and the world, generally—can move rather quickly out of this depression, back toward general prosperity.

It is not necessary for you, as a citizen, to accept my proposal. You have the right to reject my analysis: you have the free will right to starve.

Step One: Monetary Action

The first step is to supply low-interest credit to essential goods-producing industries and farms.

The federal government has the power to monetize U.S. gold reserves at a price of about $500 an ounce, using that gold to defend the dollar internationally, and to bring our allies into a new gold-reserve system, to replace the bankrupt International Monetary Fund and hyperinflationary offshore, unregulated financial system.

The Congress has the power to issue gold-reserve-denominated U.S. currency notes. These notes should not be used for government spending, but for government lending. They should be lent through the private banking system to farms, industries, transportation improvements, at interest rates not in excess of 4 percent charged by the government.

Through lending of such notes as from 10 percent to 50 percent or higher of the total lending by private banks to farms, industries and other selected categories, the basic goods-producing capacity of the United States can be saved from waves of bankruptcies. A large portion of the unemployed can be automatically reemployed, and the federal, state and local tax-revenue base can be expanded.

That is the basic solution to our problems. There is no alternative solution in sight.

Step Two: Nuclear Energy

The domestic U.S. economy requires two basic stimulants, to stimulate goods-producing employment and investment. The first of these is nuclear-energy construction.

Nuclear is the safest, cleanest, and cheapest form of energy available. Since it is the cheapest, using nuclear energy instead of more costly forms of industrial process-heat and electricity means an increase in the productivity and competitiveness of the U.S. economy as a whole. It means a very large saving in the present costs of production.

We need immediately, the construction of over 100 billion watts of nuclear electricity-producing capacity completed between now and about 1986-87, plus an additional 50 billion watts completed by about 1990. This will not cost us a penny, since this energy will represent a major saving to the economy. It is a cost-reduction, productivity-increasing investment.

This will create a level of about two and a half million work-places in the private sector. This increase will come partially in the form of putting skilled production trades back to work. The largest increase in employment will come in steel and other industries which supply construction materials for nuclear investments.

This will also stimulate investment in the most modern kinds of specialty-steel and other technologies, meaning that our Midwestern states' economies can be rescued from the economic disaster they are presently suffering.

The federal government must facilitate completion of nuclear investments already in progress and planned to go. It must direct a flow of cheap credit into the construction phases of such projects, with private utilities taking financial responsibility for the completed plants.

Step Three: Water and Transportation

Next to the danger of a crippling energy-shortage, the U.S. economy's most critical problems are shortages of fresh-water supplies and a broken-down transportation system. Since rivers, canals, and ports are a key part of the transportation complex, fresh-water management and transportation must be treated as an integrated single effort.

The biggest single chunk of the needed programs of fresh-water management is the long-projected effort to bring water from Canada and Alaska into the states West of the Mississippi and into the Great Lakes System. This is necessary to save large chunks of our nation's food supplies from threatened disaster. For the Northeastern portion of the nation, the Delaware water project is urgently needed for even the simple household needs of the populations of New Jersey, eastern Pennsylvania, and lower New York State; this project will also improve the industrial potential of that region.

The United States also needs a rebuilding of a decrepit rail system, and requires a maritime fleet for both economic and national-security reasons.

The time has come to develop an integrated container system, and to design a compatible system of rail, truck, air, water transportation about such adopted standards. We can increase our economic capacities and effect great saving in costs of goods through such improvements. The savings are chiefly two. We save on materials-handling costs throughout the economy, and reduce in-transport inventory-costs and related capital costs of production.

Improved transportation also means the ability to develop competitive goods-producing investments in the greatest range of geographic sections.

So, like nuclear-energy investment, investment in water-management and transportation improvements represents cost-saving as well as other forms of improvement for the economy as a whole. It also means that we use the advantage of such cost-savings to create substantial amounts of productive employment.

Step Four: World Trade & Investment

If developing nations' debt-structures were reorganized in a sensible fashion, nations such as India, Brazil, Mexico represent magnificent investments in modern goods-producing capacity through proper infusions of capital goods from industrianzed nations. Between $200 and $400 billion annually in increased world-trade can be readily generated.

President Jimmy Carter's Global 2000 proposal for worldwide genocide was not only a violation of the Nuremburg Code; it is also economic imbecility.

The great need of developing nations is for rapid infusions of modern agricultural technology—not consumer-goods industries. These nations require the local capital-goods industries and transportation systems needed to apply the American System so successful in our own experience to overcoming their own wants. These local industries must concentrate on the needs of agricultural development first, and gradually expand to meet the needs of urban life as the problems of low agricultural productivity are overcome.

This is the great market for capital goods of the industrialized nations over the coming 50 years. It is time we acted to make that market a reality.

Combined Effects

The United States is probably spending more today on just two items—illegal drugs and pornography—than on national defense. It is spending far more on turning the nation into a new Sodom and Gomorrah than upon capital investments of the sort which make us productive and prosperous.

Our toleration of this immorality, this drift to becoming a new Sodom and Gomorrah, is key to our failure as a nation—both in terms of nominal leaders and the electorate—to find effective solutions to economic as well as national security and social problems.

The four steps outlined will not solve all of our important problems. They are merely four necessary steps which will point our nation's efforts in a positive and moral new direction, to give ourselves as a nation a sense of moral purpose, and to restore rationality—as opposed to the immorality of a Tom Hayden, to the nation and to the mass of wreckage presently known as the Democratic Party.

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GOVERNMENT RELATIONS

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Testimony

of

Willard H. McGuire
President
National Education Association

before

Senate Budget Committee

March, 1982

Mr. Chairman and Members of the Committee, I am Willard McGuire, President of the National Education Association.

Our organization represents 1.7 million men and women in the field of education in every state in the United States.

We are honored to testify before you today and we do so with a sense of intense urgency. After careful analysis of the impact of the Reagan Administration budget on education on a state-by-state basis, we believe that the destruction of educational support from the federal level is penny-wise and pound-foolish (attachment 1).

This budget, if it were adopted, would slash programs which have been targeted to increase access to educational opportunity, to enhance the quality of education, and to provide financial assistance to local school districts. It would slash support for proven, successful programs at a time when states and localities are unable to meet existing budgets. It would slash support for education today but the short-term savings means long-term costs in terms of productivity and national security.

This testimony, Mr. Chairman, addresses several crucial questions.

- o Does this budget really impact on children?
- o Can states and localities make up the difference?
- o Is there an appropriate federal interest in education for our national security and role in international competition?

THE PROPOSED REAGAN ADMINISTRATION BUDGET FOR EDUCATION IMPACTS THE EDUCATION OF MILLIONS OF CHILDREN

Sometimes it is difficult to see children when budgets are discussed in mega-dollars. The Reagan Administration has proposed a new reduction of 27 percent in education funding for FY83 accentuating a trend begun last year.

One of the programs which is hard hit is Title I of the Elementary and Secondary Education Act (to become Chapter 1 of the Education Consolidation and Improvement Act on July 1, 1982). Title I currently reaches only 45 percent of the 11 million children who are eligible as low achievers in 14,000 school districts across the country. It is a program which should meet all of this Administration's criteria for effectiveness--decisions are made at the local level; significant gains are made by the participants in the most basic of basic skills, reading and writing; the program reaches 86 percent of local school districts with funds to concentrate on the needs of disadvantaged children. Moreover, a study conducted for the Department of Education has concluded that Title I is an effective program which works, benefitting the very children for whom it was designed.

And yet this Administration proposes to cut the program over 40 percent from $3.5 billion available this school year to $1.9 billion. Under this budget an additional 2.3 million children will not be served and 80,000 specially trained teachers and staff will lose their jobs.

Figures have been made available to the Committee staff which show the impact on large school districts represented by this Committee. Title I is only one of the cuts but it would have the following effect in:

City	Staffing		Children Served	
	81-82	83-84	81-82	83-84
Birmingham, Alabama	427	276	12,887	8,330
Boston, Massachusetts	563	365	15,208	9,857
St. Louis, Missouri	664	426	24,333	15,636

The proposed cuts in other elementary and secondary education programs will have similar effects on the education of children (see attachments 1 and 2). The cuts in impact aid, vocational education, handicapped education, bilingual education, and others hit the classroom and millions of students across America and NEA objects.

The Administration budget document purports to show a decreasing proportion of support for elementary and secondary education because of an increasing proportion of funds going to higher education. Since the majority of the higher education programs are entitlements, this is patently false and the argument is designed to split the education community rather than plan for America's educational needs. The cuts in higher education affect upwards of two million college students and are delivered by the budget and through regulation changes which are up for review.

The Reagan Administration is mounting an all-out assault on federal student aid. The 1982 budget cuts in Social Security and guaranteed student loans and grants started the trend. The 1983 cuts go even deeper. And proposed federal regulation changes round out the activity.

NEA objects to the Administration's plans to:

- cut Pell grants for needy students from $2.6 billion to $1.4 billion--knocking one million students off the rolls. No family earning over $14,000 would be eligible for the grants;

- cut $1 billion in the college work study program and cut other direct student aid in half;
- cut graduate students out of the guaranteed student loan program. Now about 600,000--more than half of those enrolled--rely on these seven or nine percent loans. Some students will be able to borrow money under another loan program. But it's at a 14 percent interest rate--and the program isn't offered in every state.

The other popular student aid program--National Direct Student Loan--would be seriously cut back under proposed Department of Education regulations. This program provides federal funds to institutions to lend to low-income students at five percent interest rate.

STATES AND/OR LOCALITIES ARE UNABLE TO MAKE UP THE DIFFERENCE

I am joined in my testimony today by Carol Doherty, President of the Massachusetts Teachers Association, and Jimmy Williams, Acting Executive Secretary of the Georgia Association of Educators, who will provide you with firsthand information about their states.

According to recent statistics released by the National Governors Association, 30 states will end this year in the red or within one percent surplus. The state fiscal situation is directly related to whether there is an ability to take up the slack of education funding dropped by the federal government. Five examples make the case in real terms:

Minnesota is facing an extreme fiscal crisis, with a projected budget deficit in the current biennium of $1 billion. The legislature is considering an across-the-board cut in education funding of about 8-12 percent. It has stated repeatedly that it will not attempt to pick up the slack for losses in federal aid to education (elementary/secondary program loss '81-'83 more than $35 million).

California's schools have suffered a ten percent reduction in state aid as a result of Proposition 13 alone. Facing a budget deficit of about $500 million, the state will be unable to replace losses due to inflation, federal aid reductions, and further property tax reductions. Indexation of the state income tax has resulted in revenue growth of only 1.9 percent in the last fiscal year (elementary/secondary program loss more than $213 million).

Mississippi's Governor and legislature are committed to holding the line on tax increases and the state education department has been told that there will be no attempt to finance losses from federal education aid, which accounts for 24 percent of the money to run the state's schools. The House has voted to deny salary increases to teachers (elementary/secondary program loss more than $40 million).

Ohio faces a $1 billion deficit in the current biennium, and the state budget director has called for a nine percent reduction in education spending this year, a 16 percent reduction next year. More than 1000 teachers are expected to lose their jobs (elementary/secondary program loss more than $75 million).

Oregon's education department is proposing elimination of the gifted and talented program and deep cuts in education of the handicapped in response to a call for 20 percent spending cuts for all state agencies. The current deficit in Oregon is $150 million (elementary/secondary program loss more than $21 million).

In forty of the states, tax caps, statutory spending limits, or other forms of spending limitations affect an ability to make up education funds particularly at a time when the recession is decreasing revenues; federal budgets for a wide variety of programs are declining; and the need for services in expanding. According to NGA the percentage of total state and local revenues provided by the federal government has declined from 25.3 percent in 1981 to 18.3 percent in 1983.

States were providing an average of 48.8 percent of the education budget before the squeeze of budget cuts and the recession but the range was 16.7 percent in Nebraska to 87.1 percent in Hawaii (attachment 3).

In voting on President Reagan's budget for education, Members of Congress must presume that funds cut in Washington cannot be made up by state governments. The only way to fund these programs will be through local tax increases--usually the property tax. According to a report by the Tax Foundation as reported in the New York Times, Sunday, February 21, 1982, local property taxes have already reversed the downward trend of the 70's.

THERE IS AN APPROPRIATE FEDERAL ROLE IN EDUCATION FOR THE PROTECTION OF NATIONAL SECURITY AND OUR COMPETITIVE ADVANTAGE IN THE WORLD TODAY

The Reagan Administration budget proposal not only destroys the funding base for important educational programs but also proposes a narrowly structured and virtually powerless agency called the Foundation for Education. Assistance to replace the Cabinet level Department of Education. The Foundation proposal is part of a major effort to diminish the federal role in education, if not eliminate it. The Foundation would be outside of the arena where decisions are made about national policy and the future of America and those decision in turn would be outside of Congressional review with a director and staff appointed by the President.

The National Education Association believes that the goals of the Congress in establishing the Department of Education are being met.

1. The Secretary of Education can be held accountable for all the educational decisions and actions taken by federal officials.

2. The Department has begun to fulfill the management and accountability goals set by the Congress including reductions of staff, elimination of duplication, and reduction of paperwork requirements and unnecessary regulations.

3. There is a clear voice for education when decisions are made about the budget and governmental policies.

4. There is a focus for equal educational opportunity and protection of civil rights.

Many of those who wish to abolish the Department of Education do not quarrel with its record. Rather, they challenge the nation's historic consensus that the federal government should support education at all. They not only wish to dismantle the Department, but also to eliminate most federal education programs and funding, transfer the emphasis for education to private schools, and discontinue federal enforcement of civil rights laws. The Reagan Administration budget--at a time when public school funds are being decimated--proposes the use of public funds through tuition tax credits for private school parents.

The National Education Association and its state and local affiliates are determined to maintain and improve the quality of education provided America's children. We are committed to the principle of equal and unrestricted educational opportunity. And we will not abandon the belief that the federal government should be an active participant in the process of achieving these goals. We are proud of our support of federal funding for education: we proclaim it. A free nation's commitment to its future is most directly demonstrated through its active support of education. The federal role in that effort is the national affirmation of that belief: it is also a realization that the federal government is the only level at which certain elements of equity can be achieved or that challenges of the future can be adequately addressed.

America must increase the skills of its work force to compete with strong economic rivals, devise effective means of training and employing an entire generation of minority youth who are in danger of slipping into a lifetime of poverty and despair, train a new generation of scientists who can tap the technological revolution and shape it for our people's benefit, and rebuild our human capital to respond to new international tensions and enhance national security.

The National Education Association rejects the education budget proposed by the Reagan Administration. We stand ready to work with this Committee and the Congress to develop alternatives which focus on the fact that public education is a key component of America's future.

Attachment 1

STATUS OF FEDERAL BUDGET FOR EDUCATION

The attached printout of selected federal education programs by state presents NEA's projections for the 1982 and 1983 Reagan Administration budgets. In a five-column format the printout shows

1) the actual appropriation for 1981
2) the continuing resolution for 1982
3) the Administration's revised request for 1982
4) the Administration's proposal for 1983 and
5) the dollar loss from 1981 to 1983.

Projections for 1982 and 1983 were made by applying each state's percentage of 1981 appropriations to the selected programs. Actual distributions will vary depending upon program qualification data which is not available at this time.

For the US as a whole, programs on this printout have been cut from 1981 to 1983 as follows:

ESEA Title I, down 34.2 percent
Handicapped, down 26.7 percent
Vocational and Adult, down 36 percent
Impact Aid, down 55.1 percent
Rehabilitation Services, down 32.2 percent

In addition, the new Title II Block Grant shows substantial reductions from the original 1982 proposal.

NEA February 22,1982

STATEMENT
OF THE
NATIONAL RETIRED TEACHERS ASSOCIATION
AND THE
AMERICAN ASSOCIATION OF RETIRED PERSONS

BEFORE THE

SENATE COMMITTTEE ON BUDGET

ON

THE FISCAL YEAR 1983 BUDGET

MARCH 26, 1982

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ABSTRACT OF TESTIMONY
OF THE NRTA-AARP
BEFORE THE SENATE COMMITTEE ON FINANCE
MARCH 26, 1982

We appreciate this opportunity to submit testimony to the Committee on the FY'83 Budget. In sum, our message can be distilled to the following essential points:

1. The income security of the nation's elderly is being eroded through a decade-long high inflation and recent and prospective cutbacks in federal and state programs.

2. Large and growing federal deficits, caused by excessive tax cuts and defense increases, are unacceptable. They lead to higher interest rates which, in turn, contribute to inflation. They also fuel public and business expectations of still more inflation. If the Administration will not, or can not, revise its budget, then Congress must assume the burden.

3. Faced with the prospect of huge and growing federal deficits, it is readily apparent that all sectors of the economy will have to sacrifice, and no area of the budget--whether in revenues or expenditures--can be exempt. In considering alternative budget proposals, we will look not only at the pain they may exact but also whether they are fair and economically sound, i.e., will they provide genuine progress toward reducing the deficits.

4. Given the eroding position of the elderly--with unprecedented increases in the share of elderly below the poverty level--proposals to drastically cut cost-of-living adjustments, cannot be accepted. The simple fact is that for many elderly, particularly the most vulnerable among them, such as single, older women, the cost-of-living adjustment is the only thing between them and poverty.

5. In order to reduce the deficit significantly and avoid even deeper cuts in basic income support programs, as well as provide for enhancement in national defense, revenues must be increased. If possible, this should be done without undoing the essential elements of the President's initial tax proposals, though ultimately some adjustment may be necessary there as well.

6. The elderly have already suffered cutbacks in basic health care programs as a result of last year's spending cuts. At the same time, inflation in the health care sector continues out of control. The Administration's Medicare/Medicaid proposals merely shift costs to beneficiaries and, even more perniciously, private paying patients. And, they do little or nothing about health care inflation. In this regard, we offer some alternatives.

7. Social security's short-term financing problems have not gone away and, due to the state of the economy, have worsened. Repeated short-term crises distract attention and energies from the more serious problems of long-term social security reform. To get the system through to the 1990's, when the trust fund balances are expected to improve, we recommend that, for a short-term, fixed period, the use of general revenues be authorized whenever trust fund balances fall too low.

I. Overview of the Economy and the Budget

The deficits projected in the near term are resulting from the current intense recession, last year's huge and ill-targeted tax cuts and the large increases planned for defense spending. Reducing the deficit and making progress toward a balanced budget is critical to the economy for several reasons.

First, large and continuing deficits are viewed by both the public and by business as inflationary. This has created an environment that is not only likely to stimulate the wage/price spiral but also dampen incentives to save and invest on the part of individuals and business. The passage of last year's Economic Recovery Tax Act has not brought about any significant dampening of the public's expectations for continued inflation and has not generated the savings and investment necessary to promote recovery and long-term economic expansion.

Second, given the Federal Reserve's tight money policy (which unfortunately has been the only effective anti-inflation program in town), large deficits will lead to soaring interest rates, making it extremely difficult for the economy to recover from the current recession. At best the result will be either stagflation or a weak recovery followed by another recession.

Lenders are demanding high interest rates out of fear that inflation will remain elevated and resurge with any recovery, no matter how modest. Uncertainty has gripped the financial markets creating havoc and damaging the long-term investment which the economy needs. While the current recession may be bottoming out, the high unemployment and business disorder give rise to fears that the recession could deepen even further during the coming months. At present, there are simply no reliable signs that a recovery is under way. The high interest rates and tight money conditions, which precipitated the present recession, will remain with us until the deficit is brought down.

With respect to defense spending, we know of no instance of deficit financing of defense expenditures that did not prove to be inflationary. National currencies in such circumstances tend sooner or later to be destroyed. The threat to the U. S. dollar that results from opting for deficit financing to accommodate large increased defense expenditures only tends to reinforce the public's and the financial market's pre-existing expectation that inflation will be renewed -- and perhaps with such a vengeance that it will climb to levels higher than any previously experienced.

The economic outlook is bleak. One of our most important industries, automobiles, is best described as "on the ropes", along with our major agricultural implement manufacturers. Housing construction is at a virtual standstill. The

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savings and loan industry which supports home construction, is in grave financial circumstances. Bankruptcy statistics of small and medium firms have been approaching depression levels. Unemployment, now close to 9 percent, is likely to go to 10 percent. Unemployment in many of our snowbelt industrial cities has been rising towards levels not seen since the Great Depression of the 1930s.

The leading indicators turned downward in January, pointing toward a continuing reduction in business activity. In fact, January marked the ninth consecutive month of decline for the index. The stock market has recently dropped to new lows and the term "depression" has reentered our economic vocabulary.

Administration spokesmen are still predicting an explosion in savings rates followed by a great flow of funds into new investment. We would be very happy to see this, but there are no advance indications of such financial developments. How can depressed economy, irrespective of the lowering of marginal tax rates, generate enough personal income to boost savings? Corporate profits and corporate cash flows have been tepid. Surveys of the plans of business for capital investment show that it is doubtful that capital outlays, after correction for inflation, will be any greater in 1982 than they were in 1981.

In August, the Administration declared that once all of their economic program was in place, public expectations of continuing inflation would diminish, interest rates would decline, and there would be a rush of investment and innovative enterprise. This has not happened and there is no good basis for believing that it will in the near future. Revising the Administration's FY 1983 Budget so that the deficits start coming down would do much to bolster public confidence in the economy in the coming months.

The recession has been virulent enough to bring about some reduction in interest rates, but they remain astonishingly high when compared to current inflation rates. We have had some temporary relief from inflation; at the end of December, 1981, the three month average for the CPI-U was only 5.3 percent. The tight money policies of the Federal Reserve Board have substantially contributed to lowering inflation rates along with an additional measure of relief from the relative stability of crude oil prices. The abundant grain crop in 1981 also contributed in important ways to slowing inflation rates.

We are most thankful that inflation rates have come down. Unfortunately, the public, and those with money to lend, simply do not see inflation remaining at low rates. Deficit projections that run as much as 50 percent higher than the Administration's projections, frighten potential lenders all the more. The dangers of depression or, more likely, the dangers of a recession lasting for months to come, are attributable to continuing high interest rates caused by massive deficits in the projected federal budgets.

The only way to dampen these fears is for either the Administration to submit a new budget to Congress with a believable program for bringing the budget into balance or for Congress to develop

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its own. Credibility must be restored to our economic programs. For some weeks now, the Administration has been working on the theme that deficits do not matter that much; they are an unavoidable part of the current economic landscape. Unfortunately, the American public firmly believes that federal budgetary deficits are a prime cause of inflation -- ironically, a view which the current Administration fostered.

Deficits do matter, not only because the public believes that they do -- and the Gnomes of Zurich believe that they do -- but because they tend to inflate the money supply and because they cause the government to dip into the national pool of savings.

II. The Elderly's Eroding Position in the Economy

The nation faces a federal budget crisis of unprecedented proportions. Annual deficits far in excess of $100 billion are being projected for each of the next three years, pushing reasonable prospects for a balanced budget out of the foreseeable future. These looming deficits are bad for the economy and, furthermore, directly threaten the already deteriorating economic position of the elderly. Our Associations are pleased that Congress is moving to revise the President's FY 83 budget. A budget impasse is something we must avoid. The consequences for the economy at large and for the elderly in particular would be disastrous.

This Committee, bears a heavy responsibility for pursuing a deficit reduction strategy that, for the benefit of all Americans, will begin to move the budget into balance. This strategy, however must be pursued in a manner that recognizes that a decade of inflation has forced the elderly into an extremely vulnerable economic position -- a position in which they find themselves heavily dependent on government entitlement programs for the bulk of their income support. This Committee must realize that the immediate consequences of large-scale cutbacks in programs, such as social security, Medicare and Medicaid, will be even greater increases in the elderly poverty rate than we are already experiencing and a more rapid deterioration in their subsistence-level standards of living.

In the past few weeks, we have witnessed a veritable flood of budget proposals and alternatives. Regardless of the specifics of each, the essence of their message is readily apparent: large, escalating deficits are not acceptable. What is acceptable is, of course, more difficult to determine.

Realistically, no Member of Congress nor any constituency group is likely to be entirely happy with what is devised. We recognize that the elderly are not likely to be completely spared some measure of pain--even though they have suffered much more than their fair share already. What we are seeking--and what we hope the members of this Committee are seeking--is a fair and balanced package which makes good economic sense by making a maximum effort to raise revenue and cut back expenditures in areas and in ways that do not do damage to program benefits of vital importance to lower income persons--especially the elderly. Cuts--particularly those in basic entitlement programs--would drastically undermine the economic situation of the elderly and leave them even more vulnerable than they already are to the escalating costs of health care and to inflation in general. At this time, it is safe to say, none of the alternative budget packages currently "on the table" meet the test of fairness and economic soundness that we have in mind.

In 1980, Data Resources, Inc. (DRI) completed a study for our Associations on "Inflation and the Elderly." That study found that the average elderly incomes (in aggregate terms) managed to slightly exceed the general rate of inflation from the late 1960's through the late 1970's. Consequently, by 1978, the average income of those over age 65 was about 55 percent of the average incomes of the non-elderly. This progress resulted from the deliberate expansion of government programs, especially social security, in recognition of the extremely high (25-30%) elderly poverty rates prevailing at that time. Also, the creation of Medicare, Medicaid and SSI helped a great deal to improve the elderly's economic status.

Despite progress made in raising the elderly's average income levels and reducing poverty among them, there is mounting evidence that inflation has begun to wipe away that progress. Elderly poverty rates, on a steady decline through 1978, increased from 13.9 percent in 1978 to 15.1 percent in 1979 and again in 1980 to 15.7% -- the largest increase in the elderly poverty rate since the Census Bureau began collecting such data and the highest poverty rate of any adult age group. We believe that the fixed nature of the elderly's income components as well as their inflexible consumption patterns -- particularly for food, fuel and medical care -- are largely responsible for the substantial increase in the elderly poverty rate.

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Moreover, despite the limited growth in the elderly's income during the period 1968-1978, the continuing escalation of the elderly's poverty rate and other statistics demonstrate the disadvantaged position of the elderly relative to the rest of the population. For example, in 1980, while only 9 percent of non-elderly households had annual incomes below $5,000, 26 percent of elderly households had annual incomes below $5,000. Similarly, only 20 percent of non-elderly head-of-households had annual incomes under $10,000, while 56 percent of the elderly head-of-households had incomes in that category. Even adding to their income the cash-value of the in-kind benefits the elderly receive does not change the reality that the elderly, as a group, generally subsist on low and in many cases wholly inadequate incomes. In 1980, over half of all individuals age 65 and above -- more than 13 million people -- had an average annual income of less than $5,000.

III. Drastic COLA Reductions Unacceptable As Budget Alternatives

Faced with rising deficits, Congress has been casting about for a relatively simple and quick means of reining in what now makes up a large portion of the budget. Cost-of-living increases in all federal entitlement programs, thus, represent a convenient target. What is ignored by those who have espoused drastic reductions in cost-of-living increases is the devastating impact such cuts would have on the elderly population -- especially for subgroups among them -- namely the oldest among them and, in particular, older women.

For millions of older persons, cost-of-living increases provided by social security and other retirement programs are the only income that stands between them and poverty. Indexing mechanisms are the only inflation protection they have. A decade of high inflation has rapidly eroded the value of their non-indexed sources of income, such as, private pensions savings and other dollar-denominated assets, which represent about one-third of their total income. This situation has left the elderly -- through no fault of their own -- heavily dependent on federal entitlement programs.

A number of Congressional budget alternatives propose to reduce cost-of-living adjustments. Perhaps the two most prominent are those offered by Senators Domenici and Hollings.

Their proposals would slash cost-of-living adjustments (COLAS) in social security as well as the other income security programs such as SSI*, civil service, military and railroad retirement and veterans' pension program. While there are some differences between these two proposals they both would: entirely eliminate the July, 1982 cost-of-living adjustments for these income security programs and, in succeeding years, provide a COLA calculated to be the Consumer Price Index (CPI) minus 3 percent. (Senator Hollings also proposes to delay the FY 83 and subsequent COLA's by shifting them from July to October. Currently, beneficiaries receive the full CPI-based COLA each July.) Based on CBO economic assumptions, this proposal is estimated to save $3.6 billion in FY 1982 and about $84-87 billion in FY 1983 through FY 1985, with over 80% of the savings from social security.

Lost in all the talk of macro-dollars and fiscal years is the likely impact of such a cut on the elderly. To explain the impact of the proposed COLA cuts in individual terms, social security beneficiaries -- by far the largest group to be affected -- can serve as valuable examples.

According to the Social Security Administration (SSA), the average social security benefit for a retired worker is $4,620 per year ($385 per month) -- only $260 above the official 1981 poverty level for singles of $4,360.

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*We understand that Senator Hollings may now be exempting SSI from this proposal.

For this average social security beneficiary, the Domenici/Hollings proposals would cut benefits in the first year by $384 (almost one month's benefit) and by $2,592 over the 1982-85 period.

Similarly, according to SSA, the average social security benefit for a retired couple is $570 per month ($6,840 per year). For a retired couple, the proposals would cut benefits in the first year by $564 and by $3,792 over the 1982-85 period.

As of 1980, according to Current Population Survey statistics there were approximately 1.3 million single women 72 or older who had total incomes of under $4000 per year, an income level very close to the poverty level. The average social security benefit received by these women was $2,619 - approximately $220 a month. Again for this same group, total average income was approximately $3,103 implying that the "average widow", 72 or older, relies on social security for roughly 84 percent of all of her income.

Even more startling, on the basis of preliminary simulations prepared by DRI (using AARP's econometric model of elderly incomes), by 1990, implementation of the Domenici/Hollings proposal would result in 39 percent of single women, age 72 or older, having incomes under $4,000 in today's dollars (this is approximately the poverty threshold for single persons). Without implementation of this proposal, "only" 26 percent of women age 72+ would be in poverty. The Hollings/Domenici proposal would add an additional 656,000 elderly women to the poverty rolls expected for 1990. These are preliminary estimates and we will provide the Committee with additional data reflecting the impact of COLA cuts on other elderly subgroups.

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It is often argued that the CPI has significantly overcompensated the elderly. These assertions are wrong. The best studies show that the elderly concentrate their expenditures on necessities -- food, fuel and utilities and medical care -- the prices of which have risen rapidly. Therefore, while there has been slight overcompensation in some years, there has been undercompensation in other years.

Many have argued that the elderly have additional outside income, and can afford a cut, i.e. no adjustment for increases in the cost-of-living. Given the nature of social security -- a social insurance program and not a means-tested welfare program -- some individuals in social security could get by. But, this is a minority. Again, one must consider the facts:

- The elderly are an extremely vulnerable, lower income group, especially compared to the non-elderly -- in 1980, 56% of elderly headed households had income below $10,000 and 26% had incomes below $5,000.

- Poverty rates among the elderly are the highest for any adult age group and are rapidly rising. For two years in a row, the aged poverty rate escalated dramatically from 13.9% in 1978 to 15.1% in 1979 and up again in 1980 to 15.7%. Reducing cost-of-living protection would worsen this trend.

- So many of the elderly have incomes just above the poverty line, that a crop of $20 to $24 a week in their average income in 1980 would have caused the aged poverty rate to soar to over 25%.

For many elderly, cost-of-living increases are the only income keeping them out of poverty. (It cannot be forgotten that SSI, an income security program for the poor elderly, would also be subject to this cut.)

- In addition, the elderly -- particularly the most vulnerable among them (the oldest and widows) -- have just been hit by over $4 billion in cuts in federal programs serving their health, nutrition, and basic income needs as a result of last year's budget cuts. And cuts in many of these programs are on the agenda again this year. Drastic cuts in COLA's would be a major step backwards by taking the "security" out of the income security programs on which the elderly depend.

- COLA cuts would fall disproportionately on the lower-income elderly since they depend most heavily on social security for income. Social Security represents roughly 80-95% of total income for elderly (age 65+) singles and families with incomes below $5,000. For elderly singles and families with incomes of total income. Hence, COLA cuts would mean the largest percentage reduction in total income for low-income elderly groups.*

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*For further information on dependency on Social Security by the elderly see the attached study prepared for our Associations by Dr. Thomas C. Borzilleri: "The Distribution of Income and Social Security Benefits Within the Aged Social Security Beneficiary Population in 1980".

•COLA cuts would fall most heavily on single elderly persons (many of whom are widowed) since as a group they have the lowest incomes, highest poverty rates, and the greatest dependency on social security for total income. In 1980, single women age 65-71 experienced a poverty rate of 22.8% and single women age 72+ experienced a 29% poverty rate -- more than double the poverty rate for the general population. Single women age 65+ with incomes below $5,000 depend on social security for 80-85% of their total incomes. Nearly identical poverty rates and social security dependency rates are experienced by single men age 65+.

IV. The Need to Raise Revenues

To protect the economy and the well-being of the elderly, the budget deficit must be reduced in a manner that is consistent with the goal of achieving economic recovery and will reduce the mounting pressure to cut entitlements. To do this, the Associations believe that revenues must be increased. As a first step, we feel that Congress should take a careful look at the tax code to remove tax expenditures that may no longer be useful. Also, new taxes may have to be implemented and existing ones raised. Finally, if these measures do not raise a sufficient amount of revenue, portions of the Economic Recovery Tax Act of 1981 should be scaled back or repealed.

The following provisions do not cover all revenue-raising possibilities. However, the Associations offer them as an indication that significant revenue can be raised without jeopardizing economic recovery. In fact, we believe that measures such as these are absolutely essential if economic recovery is to occur at all.

1. Repeal tax expenditures if their costs outweigh their economic usefulness

Changing economic circumstances make it imperative for Congress to periodically review tax expenditures (i.e., tax provisions that cause revenue loss) to determine their expense and their value. If Congress can control the growth of tax expenditures, it will take a major step toward stabilizing the federal budget.

a) According to the Congressional Budget Office[1] a repeal of certain oil and gas industry tax expenditures could raise $10 billion in FY 1984. $1.6 billion can be gained by repeal of the percentage depletion allowance, which is a write-off of 18 percent (in 1982) of the gross income (up to a limit) from select oil and gas wells. This method often allows the well owner to recover much more than the cost of extraction. Additionally, $8.4 billion can be raised by repeal of the expensing provision for intangible oil and gas drilling costs. This would allow certain oil and gas drilling costs to be written off in the year they occurred rather than adopting the general approach of depreciating these costs over a period of years. Given the major restructuring of the corporate income tax that was a part of the Economic Recovery Tax Act of 1981 and the rapid increase in energy prices, these incentives to produce may no longer be necessary.

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[1] Unless otherwise stated, the revenue figures can be obtained in the Congressional Budget Offices' Report to the Senate and House Committees on the Budget, Part III: Reducing the Federal Deficit: Strategies and Options. February 1982.

b) The deductibility of consumer interest payments will cost $7.8 billion in FY 1984. Because of the increasing need to encourage people to save and invest, this tax expenditure may be counterproductive. Also, the tax break is available only to persons who itemize their deductions in computing their income tax liability.

2. Portions of the Economic Recovery Tax Act of 1981 can be modified without harming the Act's intent

a) The corporate "leasing" provisions will cost about $4 billion in FY 1983. If leasing is felt to be desirable, Congress should at least structure the law to limit its applicability.

b) Repeal of the Windfall Profits Tax reductions would save $1.7 billion in FY 1983 and $2.2 billion in FY 1984. The Windfall Profits Tax provisions include an exemption for some royalty owners, reduced rates for certain oil of independent producers, a reduced rate on newly discovered oil and an exemption for oil rights owned by qualified charities that care for children (the last item has a very small revenue loss figure). Source: Joint Committee on Taxation Summary of H.R. 4242.

3. New or increased taxes which are consistent with an economic recovery program should be implemented

a) A windfall profits tax on deregulated natural gas could raise up to $12 billion in FY 1984 if decontrol were moved ahead to January 1, 1983.

b) Doubling the liquor tax will raise $3.5 billion in FY 1984.

c) Doubling the excise tax on beer and wine will raise $1.3 billion in FY 1984.

d) Doubling the cigarette tax will raise $1.8 billion in FY 1984.

The taxes discussed in proposals (b) - (d) were last raised in 1951.

4. The indexing of the income tax brackets, the zero bracket amount and the personal exemption that is due to begin in 1985 should be repealed or delayed until economic conditions improve

The Associations realize that bracket creep due to inflation has increased the tax burdens of workers. However, the existence of the indexing feature in 1985 builds revenue losses into the future on top of massive deficits. The future deficit projections are creating havoc with the credit markets. We feel that a willingness to resolve the long-term deficit problem should be displayed prior to the introduction of an indexing system into the code.

5. If the deficit reduction measures listed above (along with others Congress may choose) are insufficient, the personal tax rate reductions that are included in the Economic Recovery Tax Act should be postponed or scaled back or even repealed

While we believe that this should be a last resort for Congress, a postponement of the rate cuts may be needed to improve the deficit situation. A postponement of the July 1983 ten percent cut will save $27 billion in FY 1984.

In total, these measures (excluding #4) will reduce the federal deficit by about $70 billion in FY 1984. Depending on when they are implemented, they would also have a positive impact on the FY 1983 deficit.

V. Health Care Cost Inflation and Medicare/Medicaid

A. Medicare

The elderly are well aware of the escalating increases in health care costs and the pressure such increases have generated to slash the Medicare program. Last year the Congress chopped $1.5 billion out of Medicare, resulting in a 27 percent increase in the elderly's out-of-pocket costs for Medicare deductibles and co-payments which in turn automatically caused substantial increases in the elderly's out-of-pocket costs for supplementary Medicare insurance.

The Administration's Medicare proposals fail to address the major source of escalation in Medicare expenditures -- explosive hospital cost inflation. Instead, their proposals merely shift the cost directly or indirectly to program recipients and private paying patients.

The Associations believe that any changes in the Medicare program must be evaluated by criteria that: (1) address the source of pressure on the Medicare program (i.e., spiralling hospital costs); (2) contribute to the development of less expensive, appropriate care; (3) avoid cost shifting to program beneficiaries and (4) encourage the elderly to be independent. Thus, with these four criteria in mind, the Associations offer the following comments on the Administration's major proposals to cut Medicare.

•Forcing employers to pay health insurance coverage for older workers (savings, $306 million, 12.2 percent of the total projected Medicare savings in FY'83). Making the employers' health insurance plan the primary source of coverage for older workers health care claims will force up the cost of employing older workers because the employer's health insurance carrier, faced with primary responsibility for covering health claims heretofore covered by Medicare, will insist on being compensated for the additional risk of exposure. Moreover, despite the Age Discrimination in Employment Act's provision allowing employers to provide reduced health insurance coverage for older workers (so long as the employer spends the same amount on premiums for older workers as younger workers), this proposal forces employers to provide health insurance coverage for older workers as equal to the coverage provided younger ones on the penalty of not being permitted to claim the full cost of health insurance premiums as a tax deduction.

•Reduce waste and service utilization (savings, $372 million, 14.9 percent of the total projected Medicare savings in FY'83).

The thrust of this initiative is to give Medicare contractors greater responsibility for the identification and reduction of waste in the provision and use of health care services. Yet, despite nearly 9 percent inflation, the Administration refuses to provide additional funds to pay contractors for this additional responsibility. Moreover, this proposal appears to conflict with another of the Administration's proposals -- that is, to eliminate federal funding for Professionals Standards Review Organizations (PSROs) in July of this year. PSROs' responsibilities include the Administration's objective of reducing unnecessary utilization. Therefore, it is inconsistent for the Administration to propose the demise of PSROs while at the same time stress the need for increased utilization review to produce substantial savings.

Our Associations are very skeptical about this proposal. Though details are not yet available, it is difficult to see how the large savings claimed are possible merely from "eliminating waste and over-utilization." Forced to achieve such savings, Medicare contractors are likely to disallow heretofore covered expenditures or to make the reimbursement process even more cumbersome, difficult and confusing for beneficiaries than it already is.

- 2 percent reduction in reimbursement to hospitals for the care of Medicare patients (savings, $653 million, 26 percent of the proposed Medicare savings in FY'83).

A large reduction in program expenditures under this proposal are likely to be illusory because hospitals can easily make up the loss by ordering more ancillary services. Moreover, since the federal reimbursement rate is already 16-20 percent below what hospitals charge their private pay patients, such Medicare specific cuts will likely shift more cost to private patients.

The Associations believe that this proposal contributes nothing to solving the real crisis facing the Medicare program, namely; restraining the exorbitant increases in hospital costs. Furthermore, it is likely that any savings realized under this proposal would be shifted to private paying patients.

- Indexing the Medicare Part B deductible to the Consumer Price Index (savings, $65 million in FY'83); institute co-payment for home health services (savings, $35 million in FY'83); establish Medicare eligibility at the beginning of the first full month after attaining age 65 (savings, $145 million in FY'83).

Taken together, these proposals represent 9.8 percent of the Administration's projected Medicare savings in FY'83. They seem to be predicated on the notion that the elderly should bear a greater portion of the health care costs under Medicare in order to increase cost-consciousness. The elderly are already, however, extremely cost-conscious -- paying about 43 percent of their total health care expenditures out-of-pocket. They simply cannot afford to absorb additional cost-sharing under Medicare.

The Administration cites certain findings of a recent General Accounting Office (GAO) report as justification for charging a co-payment for home health services under Medicare. The Administration's proposal to require beneficiary co-payment, however, is a misdirected solution to the problems in home health services identified by GAO. Furthermore, the introduction of a co-payment for home health services, contrary to the Administration's intended purpose, could result in greater Medicare cost because patients, in order to avoid increased out-of-pocket costs, would choose to remain either in the hospital or a skilled nursing facility.

Later this year, the Administration will propose measures to improve market forces in the health care industry and in the Medicare program. No costs or savings from these efforts are assumed until 1984, and as yet, no details have been specified. Since the program is likely to include, however, a voluntary Medicare voucher plan and a new Medicare co-payment, the Associations feel that a comment on this proposal is appropriate at this time.

The proposal, as we understand it, includes a voluntary voucher plan, a new Medicare co-payment of 10 percent of the daily cost of a hospital room, up to a maximum of $26 per day, for the 2nd through 60th day of hospitalization, and a catastrophic stop-loss provision that would indemnify Medicare beneficiaries for all covered hospital and physician costs above $2500 or $3000 per year. (The stop-loss protection does not include expenditures incurred for noncovered service, such as, outpatient prescriptions, eyeglasses, nursing home care, etc.)

To the extent that a voluntary Medicare voucher proposal contributes to reforming this nation's costly health care delivery system, the Associations welcome the dialogue such a proposal would create. At this point, however, we are skeptical about any plan that includes substantial new out-of-pocket costs for Medicare patients. The elderly are still absorbing the substantial increases in Parts A and B deductibles and coinsurance enacted last year. Moreover, the catastrophic stop-loss protection, while it would aid a small number -- perhaps 3% -- would be in exchange for a doubling of cost for the average hospital stay of a Medicare beneficiary.

Therefore, the Associations believe that employers' and the employees' health insurance tax preference should be conditional on their group health insurers' adhering to

Medicare established hospital reimbursement limits and offering a variety of health plans, including HMOs. This will create incentives to hold down skyrocketing hospital costs. By conditioning these tax expenditures in such ways, the powerful incentives to develop more comprehensive health insurance coverage will be reduced and pressure from employers and employees on carriers and providers will hasten the development of less expensive health care delivery systems.

On the supply side of tax expenditures, severe and immediate limitations should be placed on the tax exempt status of hospital bonds. (For hospitals able to demonstrate the need for new construction in a growth area, this subsidy could be retained or gradually phased out.) Approximately half of the funding for hospital capital projects comes from tax exempt bonds ($5.1 billion of these bonds were issued in 1981). The direct federal revenue loss from all outstanding hospital bonds in FY 1982 will be $700 million. Our Associations seriously question the efficacy of this subsidy which allocates resources on the basis of a hospital's financial standing rather than the need for such facilities. Moreover, the magnitude of this subsidy promises to substantially increase should local health planning and the certificate of need process be phased out as the Administration has proposed. In those areas of the country that are already overbedded, tax exempt hospital bonds further escalate Medicare and Medicaid reimbursement levels for empty unneeded beds. Every $1 saved by borrowing hospitals costs $1.33 in lost federal revenue.

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The Associations recognize a responsibility to suggest alternatives to the Administration's Medicare budget proposal. In that spirit and in light of the current fiscal dilemma, we urge this committee to thoroughly examine the efficacy of tax expenditures in the health sector. Unlike Medicaid, which is a direct federal health subsidy benefiting the poor, health insurance tax expenditures are indirect federal health subsidies that, according to the Department of Treasury, primarily benefit the middle and upper income groups.

Between 1975 and 1979, Medicare expenditures grew at an annual rate of 17 percent per year. At the same time, health insurance related tax expenditures grew at an average annual rate of 19 percent per year. It is grossly inequitable to continue cutting direct federal health subsidies, like Medicare and Medicaid, while ignoring the fastest growing federal health subsidy -- health related tax expenditures. Furthermore, these tax expenditures have created powerful incentives for comprehensive, first-dollar health insurance coverage; this trend has promoted excessive increases in health care costs, including the costs of the Medicare and Medicaid programs.

The Associations have long urged the Congress to place federal limits on increases in hospital revenues per admission. Such an across-the-board approach would not single out Medicare or Medicaid beneficiaries for special restrictions. Time and again, experience has demonstrated that Medicare-Medicaid specific approaches to hospital cost containment merely lead to cost shifting and thus, no reduction in the rate of increase in total hospital costs.

Unfortunately, Congress has rejected the imposition of uniform, across-the-board limitations on increasing hospital costs. Alternatively, the Associations recommend that Congress actively encourage the states to adopt mandatory hospital rate review programs. Such programs have been successful in the six states that have them because they reduce both public and private sector outlays for hospital care. As an incentive for states to institute rate review programs, the Federal Government might share a portion (perhaps one-third) of the savings in Medicare and Medicaid costs that are achieved through rate review programs in the States. Providing financial incentives for states to initiate effective hospital rate review programs could produce substantial savings to both government and private purchasers of hospital care services.

The Associations also would like to briefly comment on other budget proposals that, while not in the Medicare program directly, would clearly escalate Medicare outlays.

First, the proposed phase-out of federal support for local health planning in FY 1983 risks substantial increases in health care costs. In essence, the Administration is offering health care competition in lieu of regulatory "barriers" in the marketplace. While we believe that incentives can change the health care delivery system in constructive ways, we seriously doubt that "competition" alone can provide the strong constraining mechanisms required to control spiralling costs in the health care sector. Moreover, we question the wisdom of dismantling the only proven, locally based cost-containment program in place, before the efficacy of "competition" to control costs has been demonstrated. The Associations view health planning and the certificate of need process as a viable state and local decision-making process which has demonstrated success in the battle against rising health care costs.

In their haste to eliminate health planning and deregulate the health care marketplace, the Administration will create a void in which costs will skyrocket -- especially Medicare cost reimbursement for hospital capital expenditures.

The Associations urge the Congress to maintain a viable local health planning presence and capability that will help contain the increase in health care costs and thus, the cost escalation in Medicare in FY 1983 and beyond.

Finally, the Associations urge the Congress to provide elderly Medicare beneficiaries equal access to Health Maintenance Organizations (HMO) through changes in the way Medicare reimburses for services. This would result in real, long-term savings to the Medicare program. As individuals, the elderly for the most part cannot enroll in HMOs. Changing reimbursement from a cost plus to a prospective, prepayment basis for Medicare beneficiaries, with required open enrollment periods, would act as a powerful incentive for the development of the HMO option for all segments of the population. Clearly, retrospective, cost-based reimbursement is not financially attractive nor viable for all but the largest and richest HMOs. Without making these reimbursement changes, the elderly will, for the most part, continue to be denied access to HMOs and Medicare outlays will continue to escalate at unnecessarily high rates.

B. Medicaid

Approximately 3.6 million low-income aged individuals -- 1 out of every 7 older Americans -- will be Medicaid beneficiaries in 1983. As the primary public health care program addressing the long-term care needs of the elderly, Medicaid is an essential program for this vulnerable segment of our population.

The Medicaid provisions in the Omnibus Budget Reconciliation Act of 1981 cut Medicaid expenditures by approximately $900 million in FY 1982; they will cut another $900 million in federal Medicaid expenditures in FY 1983.

For FY 1983, the Administration is requesting new Medicaid cuts totalling $2.0 billion. The cuts proposed reduce federal program costs by shifting them to the states, program beneficiaries and their relatives. Yet, most states have already reported funding problems and beneficiaries, by definition, are low-income individuals — those least able to afford increasing out-of-pocket expenditures for health care.

Three major Administration proposed cuts are described below. They represent over 50 percent of the proposed reduction in federal Medicaid spending for FY 1983. Like the Medicare proposals, unfortunately, the Medicaid proposals do not address the underlying cause of escalating Medicaid expenditures -- soaring inflation in the health care sector.

1. Reduce the federal match by 3% for optional services and beneficiaries (savings: $600 million; 30% of the

proposed Medicaid cuts in FY 1983).

This proposal reduces federal Medicaid matching payments to the states for optional services to the categorically eligible and for all services provided to the medically needy by 3 percent. The effect of this cut is to shift costs from the federal government to the states.

The majority of states are already facing, however, severe financial strains in their Medicaid programs; hence, many states are cutting back on optional services and restricting eligibility for Medicaid. This proposed reduction -- on top of the 4% reduction in the federal share of Medicaid already scheduled for FY 1983 -- will result in states making additional cuts in optional services and further restricting eligibility.

For the elderly who depend on Medicaid for long-term care, this cut further threatens the availability of qualified skilled nursing facility (SNF) and intermediate care facility (ICF) services. ICF care would be particularly hard hit; as an optional service, it would be subject to a 3% reduction in the federal match for every beneficiary.

Furthermore, optional services include prescription drugs, dental care, eyeglasses, and hearing aids. These are critical services to elderly beneficiaries struggling to maintain functional independence. The introduction of or increase in co-payments for these services...or their total elimination...will reduce the elderly's access to needed care.

2. Allow states to recover long-term care (LTC) costs from beneficiaries' adult children and estates (savings: $283 million; 14 percent of the proposed Medicaid cuts in FY 1983).

This proposal would allow states to require adult children of institutionalized Medicaid beneficiaries to contribute to the cost of their parent's care. Inherent in such a policy decision, however, are difficult problems of definition, equity and perhaps, due process of law. For example, could children living in one state be forced to contribute to nursing home care for their parents living in another state? Should children be required to support their parents, even in instances where the parents provided little or no support to their children? How would adult children be defined (i.e., biologically related, step-children)? If the children refused to contribute, would the parent be denied care?

Moreover, elderly individuals needing nursing home care are likely to be over 75 years old. Their adult children may be nearing retirement or already retired themselves -- living on fixed incomes with their own health care needs increasing. If the adult children are younger and have families of their own, the choice may become paying for their parents' nursing home care or sending their own children to college.

3. Establish co-payments for Medicaid mandatory services (savings: $329 million; 16 percent of the proposed Medicaid cuts in FY 1983).

The Administration is proposing to require a $1.00 and $1.50 per visit co-payment from the categorically and medically needy, respectively, for physician, clinic, and hospital out-patient services; $1.00 and $2.00 per day co-payment for in-patient hospital care would be required of the categorically and medically needy, respectively, as well.

As with the Medicare proposals to increase beneficiary cost-sharing, this Medicaid proposal is based on the notion that beneficiaries should be more cost-conscious about health care services; if co-payments are instituted, beneficiaries will "think twice" before utilizing these services.

While the stated purpose is to discourage the use of unnecessary care, cost-sharing could cause beneficiaries to postpone obtaining needed care until the illness or injury reaches crisis proportions. This could result in higher treatment costs over the long term.

In addition, these co-payments -- added to existing and expected co-payments for optional services (if those services continue to be provided at all) -- would create a hardship for Medicaid beneficiaries who already are, by definition, low-income people.

Beyond proposals with large dollar savings, however, the proposed Medicaid cuts reveal a serious lack of empathy for some of the most vulnerable of this nation's citizens. The Administration's proposal to reduce states' acceptable error level to zero over a four year period is a case in point. While the Associations recognize that errors must be held to a minimum, human experience portends that it is not realistic to expect a zero error rate in a $32 billion program as complex as Medicaid. The effect of this policy phase-in will be to deny Medicaid services to those who are unable to document every detail of their Medicaid application. States faced with a prospective disallowance for services already rendered, will turn down otherwise qualified applicants because the information on their applications is either marginal or of a preliminary nature. Instead of offering help and hope, Medicaid will become a harsh and arbitrary, inflexible bureaucratic quagmire.

Furthermore, the Administration's intention to eliminate special matching rates for nursing home inspections is a serious threat to the most vulnerable aged. The federal government's encouragement of nursing home inspection programs is based on years of documented nursing home abuses. The Administration's retreat in this regard is particularly unfortunate, especially in light of the severe cuts in nursing home reimbursements described herein and HCFA's continuing efforts to "deregulate" the nursing home industry.

VI. Social Security

In FY 1982, more than 95 percent of the nation's citizens 65 or older, and their dependents, will be eligible for social security benefits. About 36 million persons receive OASDI benefits, and more than 115 million workers currently contribute to the system.

Federal outlays for OASDI totalled $139.6 billion in 1981, are estimated to total $158.1 billion in 1982, and (based on CBO's baseline projections) will total $173.6 billion in 1983.

There is a general consensus that the social security system is facing short-and long-term financing problems due, in large part, to demographic trends and unfavorable economic conditions. While action is needed to assure solvency of the social security trust funds in the future, the budget cutting process is not an appropriate forum in which to address this problem.

Last year, the Congress and the American public overwhelmingly rejected the Administration's proposal to make massive cuts in social security. However, this essential entitlement program did not go unscathed during the budget process. The combination of the 1981 Omnibus Budget Reconciliation Act and the Social Security Amendments of 1981 (H.R. 4331) resulted in social security cuts including: elimination of the minimum benefit for new beneficiaries; phase out of post secondary student's benefits; phase out of mothers' and fathers' benefits when youngest child is aged 16 and over; elimination of lump-sum death benefit when there is no surviving spouse or surviving entitled child; and retaining the retirement test exempt age at 72 through 1982.

The combined effect of all enacted 1981 social security legislation resulted in spending cuts totalling $2.127 billion in calendar year (CY) 1982 and $2.854 billion in CY 1983.

Recognizing both the system's financing problems and the political sensitivity of the issue, the President created a fifteen-member National Commission on Social Security Reform. This commission, given the task of developing a bipartisan solution to social security's financing problems, is not to report back until the end of 1982. Therefore, with the Administration waiting for the results of the commission's work, it did not include any social security (OASDI) proposals in its FY 1983 budget.

As we have testified before Congress previously, social security faces a serious short-term deficit which is expected to persist throughout the 1980s. This situation is the result of adverse economic conditions. Congress has little choice but to develop a remedy for the short-term deficit, since exhaustion of the reserves of Old Age and Survivors' Insurance (OASI) Fund as well as the Hospital Insurance (HI) fund is projected to occur soon. Interfund borrowing, reallocation of the payroll tax rates or any other type of pooling of trust fund reserves cannot be relied upon to carry the system safely through this decade. Indeed, recent projections indicate that interfund borrowing which was only recently authorized by Congress will prove inadequate as early as mid to late 1983.

Rather than drastically reducing benefits through cuts in cost-of-living adjustments or other precipitous, hasty benefit curtailments, Congress should cushion the system by using limited and temporary amounts of general revenue -- just enough general revenue to permit it to meet its short-term benefit obligations. Our Associations recognize the reluctance to authorize the use of general revenue funds for social security. However, if the Congress continues to face one after another short term "crisis" in social security's financing -- again, largely due to worse than expected performance by the economy -- the more serious long term reform of social security will take a back seat. And, for each year that this task is delayed its resolution becomes more difficult. Once the social security system is stabilized, as is expected after 1990, any use of general revenues should automatically cease. Action to implement this plan however, should be accompanied by initial steps toward resolving social security's long-term deficit. Our Associations testified before the Senate Finance committee last July outlining our proposals in detail for long-term reform of social security and look forward to working with both this Committee and the Finance Committee in the coming months in this regard.

VII. Conclusion

The nation faces a federal budget crisis of unprecedented proportions. This Committee, bears a heavy responsibility for pursuing a deficit reduction strategy that, for the benefit of all Americans, will begin to move the budget into balance. This strategy, however, must be pursued in a manner that recognizes that a decade of inflation has forced the elderly into a position in which they find themselves, through no fault of their own, heavily dependent on government entitlement programs for the bulk of their income support. The immediate consequences of large-scale cutbacks in programs like social security, Medicare and Medicaid will be even greater increases in the elderly poverty rate than we are already experiencing and a more rapid deterioration in their subsistence-level standards of living.

What we are seeking is a fair and balanced package which makes good economic sense by making a maximum effort to raise revenue and cut back expenditures in ways that do not do damage to program benefits of vital importance to lower income persons--especially the elderly.

Attachment A

THE IMPACT OF PROPOSALS TO MODIFY SOCIAL SECURITY COST-OF-LIVING PROVISIONS ON AGED POVERTY, 1985 AND 1990

Prepared for the American
Association of Retired
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Markets Service, Data
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March, 1982

SUMMARY

The DRI-AARP Age-Income Model was used to produce computer simulations of the effect on the elderly income distribution of two proposals to modify the cost of living provisions of the social security system. Two proposals were simulated. The first omitted the COLA for 1982 and from 1983 forward, provided benefit adjustments of inflation minus three percent. The second proposal substituted a two-thirds of the increase in the CPI rule, beginning in 1983.

The inflation minus three proposal would result in an additional 1.2 million elderly persons in poverty by 1985 and an additional 2 million persons in poverty by 1990. The two-thirds rule results in an additional 500,000 persons in poverty by 1985 and an additional 1.3 million by 1990. Impacts from either proposal are not uniform within the aged income distribution. This reflects the great variability in the degree to which the aged depend upon social security as a percentage of total income.

I. Introduction

This report briefly summarizes the results of a series of computer simulations undertaken to investigate the effect on the elderly income distribution of two proposals to modify the cost of living provisions of the social security system. The two proposals simulated were both under discussion in March 1982. One proposal would omit the cost of living adjustment scheduled for July of 1982 and for future years, would adjust social security benefits by inflation minus 3 percent. The other proposal suggests that the 1982 adjustment occur as scheduled, but from then on, only 66 percent of the measured change in the price level would be added to benefits for inflation adjustments Although there are a variety of similar proposals, only these two were simulated since they seemed representative of what the Congress was considering as measures to reduce projected federal budget deficits.

The simulations were performed by the Consumer Markets Service of Data Resources Inc., Lexington, Massachusetts, utilizing a computer model developed during the past year for the American Association of Retired Persons, Washington, D.C. This report was prepared by Dr. Thomas C. Borzilleri, a consulting economist for the AARP, who also assisted in the development of the model and directed the specifics of the policy simulations included in this report. Funding for both the development effort and for the policy simulations was provided by AARP. Complete technical documentation of the DRI-AARP Income Model of the Aged is available from AARP upon request.

II. Model Overview

The starting point for the simulation model is the output of the DRI long-term macroeconomic forecast which is produced each month. The AARP model then takes these forecasted macroeconomic values (interest rates, employment, inflation rates, etc.) and translates them into changes in earnings, interest income, social security income, other transfer income, and other income sources recieved by the aged population. The changes are then displayed for impacts on the income distribution of four age groups, 55-61, 62-64, 65-71, and 72 and older, for single males, single females and families where the head of the household is in one of the above age groups.

The policy simulations reported here are based on two runs of the system. The baseline simulation, covering the period 1982 thru 1990, was performed in January of 1982.* In February of 1982, the model was again run, except instead of assuming full cost of living increases thru 1990, the two proposals discussed above were assumed to go into effect either in 1982 or 1983, depending upon the specifics of each.

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*This report, "The Outlook for the Incomes of the Elderly in the 1980's", prepared by DRI for AARP, is available upon request.

Although a great deal of information is produced by the simulation model covering all of the demographic groups referred to above and impacts on six different income classes within each demographic groups, only the impacts on the low income population are reported here. Given the initial baseline simulation and expected poverty for the years 1985 and 1990, the focus of this report is how the number of persons and families with incomes below the poverty line will be altered by each of these two years by the proposed cost of living modifications.

III. Simulation Results

Tables 1 and 2 display the results of the inflation minus three proposals and indicate that implementation would increase the number of persons in poverty in 1985 by 1.2 million persons. By 1990, there would be approximately 2.0 million persons in poverty over what would otherwise be the case. These results simply reflect the fact that at lower income levels, dependency on social security as a percentage of total income is extremely high (75 to 90%)* and that even small year-to-year erosion can result in significant cumulative income reductions. For example, the three percent proposed erosion, means a 12 percent real social security benefit reduction by 1985 and a 25 percent reduction by 1990. The more heavily dependent upon social security a person is, the more the erosion in social security implies an erosion in total income.

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*The Distribution of Income and Social Security Benefits within the Aged Social Security Beneficiary Population, 1980, T.C. Borzilleri, March 1982

Tables 3 and 4 summarize the results of the 66 percent proposals. By 1985, approximately 500,000 additional persons will have incomes below the poverty level than would be the case with full cost of living adjustments. In 1990, the additional numbers below this level would be approximately 1.3 million.

It should be noted that the assumed average inflation rate in simulation for the 1982-1990 period is 7.5 percent and hence the effective erosion in the two-thirds proposal averages 2.5 percent. To the extent that either the level of inflation or the pattern of inflation is different from that which was forecasted in January by the DRI macroeconomic model, poverty counts will also be different. This is also true of course for any of the simulations undertaken with the DRI-AARP model but it is more crucial with "percentage of inflation" proposals since the effective income erosion rate will vary with the level of inflation.

Tables 5 and 6 display poverty rates by demographic groups within the aged population. It should first be noted that for all groups in the population the impact of inflation minus three is more severe than the 66 percent proposal. Both proposals however significantly increase poverty rates, particularly by 1990.

For example, by 1985 the expected poverty rate with full cost of living adjustments among single women aged 72 or older is 30 percent, with CPI minus 3 it is 37.5 percent, while with the two-thirds proposal it is 33.2 percent. For the same group in 1990, poverty could be expected to decline to 26.1 percent with full COLAs, increase to 38.6 with CPI minus 3 and to 34.3 with the two thirds proposal.

Tables 7 and 8 present the percent changes in poverty rates for the groups in question. For all groups, poverty is expected to decline by both 1985 and 1990 under the full cost of living scenario. Under either of the proposals, there is either an absolute increase in poverty or the decline in the rate is significantly reduced. It should also be noted however, that impacts are far from uniform within the aged population.

TABLE 1

POLICY SIMULATION: INFLATION MINUS 3 PERCENT
FORECASTED POVERTY COUNTS,
NUMBER OF PERSONS OR FAMILIES
BELOW OFFICIAL POVERTY LINE, 1985

Single Men	Full COLA	Proposal	Change
62-64	70,854	75,219	4,365
65-71	213,988	231,753	17,765
72+	230,040	285,250	55,210
Single Women			
62-64	192,065	203,410	11,345
65-71	803,503	939,267	135,764
72+	1,340,850	1,676,063	335,213
Families			
62-64	134,779	158,106	23,327
65-71	278,343	407,206	128,863
72+	230,206	390,915	160,709
Totals	3,494,628	4,367,139	872,561
Persons (assuming 2 per family)	4,137,956	5,323,416	1,185,460

Source: Simulations produced by DRI-AARP Age-Income Model

TABLE 2

POLICY SIMULATION: INFLATION MINUS 3 PERCENT

FORECASTED POVERTY COUNTS,

NUMBER OF PERSONS OR FAMILIES

BELOW OFFICIAL POVERTY LINE, 1990

Single Men	Full COLA	Proposal	Change
62-64	56,817	65,163	8,346
65-71	170,402	206,917	36,515
72+	195,523	293,284	97,761
Single Women			
62-64	161,889	181,162	19,273
65-71	750,617	1,012,103	261,486
72+	1,316,667	1,947,254	630,587
Families			
62-64	108,603	142,390	33,787
65-71	240,877	453,746	212,869
72+	157,022	420,265	263,243
Totals	3,158,417	4,722,284	1,563,867
Persons (assuming 2 per family)	3,664,919	5,738,685	2,073,766

Source: Simulations produced by DRI-AARP Age-Income Model

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TABLE 3

POLICY SIMULATION: 66% OF CPI

FORECASTED POVERTY COUNTS,

NUMBER OF PERSONS OR FAMILIES

BELOW OFFICIAL POVERTY LINE, 1985

Single Men	Full COLA	Proposal	Change
62-64	70,854	72,869	2,015
65-71	213,988	221,255	7,267
72+	230,040	252,533	22,493
Single Women			
62-64	192,065	194,740	2,675
65-71	803,503	864,458	60,955
72+	1,340,850	1,483,874	143,024
Families			
62-64	134,779	142,555	7,776
65-71	278,343	329,888	51,545
72+	230,206	291,015	60,809
Totals	3,494,628	3,853,187	358,559
Persons (assuming 2 Persons per family)	4,137,956	4,616,645	478,684

Source: Simulations produced by DRI-AARP Age-Income Model

TABLE 4

POLICY SIMULATION: 66% OF CPI
FORECASTED POVERTY COUNTS,
NUMBER OF PERSONS OR FAMILIES
BELOW OFFICIAL POVERTY LINE, 1990

Single Men	Full COLA	Proposal	Change
62-64	56,817	62,274	5,457
65-71	170,402	194,746	24,344
72+	195,523	257,832	62,309
Single Women			
62-64	161,889	174,223	12,334
65-71	750,617	929,043	178,426
72+	1,316,667	1,730,332	413,665
Families			
62-64	108,603	130,324	21,721
65-71	240,877	369,719	128,842
72+	157,022	314,044	157,022
Totals	3,158,417	4,162,537	1,004,120
Persons (assuming 2 persons per family)	3,664,919	4,976,624	1,311,705

Source: Simulations produced by DRI-AARP Age-Income Model

TABLE 5

POVERTY RATES BY DEMOGRAPHIC GROUP

	1980	1985		
Single Men		Full COLA	CPI-3	.66 CPI
62-64	21.3	21.1	22.4	21.7
65-71	28.6	26.5	28.7	27.4
72+	25.5	22.5	27.9	24.7
Single Women				
62-64	24.3	23.7	25.1	24.3
65-71	31.5	29.0	33.9	31.2
72+	34.4	30.0	37.5	33.2
Families				
62-64	5.4	5.2	6.1	5.5
65-71	5.8	5.4	7.9	6.4
72+	6.4	5.3	9.0	6.7

Source: Simulations produced by DRI-AARP Age-Income Model

TABLE 6

POVERTY RATES BY DEMOGRAPHIC GROUP

	1980	1990		
Single Men		Full COLA	CPI-3	.66 CPI
62-64	21.3	17.7	20.3	19.4
65-71	28.6	19.6	23.8	22.4
72+	25.5	18.2	27.3	24.0
Single Women				
62-64	24.3	21.0	23.5	22.6
65-71	31.5	24.4	32.9	30.2
72+	34.4	26.1	38.6	34.3
Families				
62-64	5.4	4.5	5.9	5.4
65-71	5.8	4.3	8.1	6.6
72+	6.4	3.4	9.1	6.8

Source: Simulations produced by DRI-AARP Age-Income Model

TABLE 7

PERCENT CHANGES IN POVERTY RATES

1980-1985

Single Men	Full COLA	CPI-3	.66 CPI
62-64	- 0.9	+ 5.2	+ 1.9
65-71	- 7.3	+ 0.3	- 4.2
72+	- 11.8	+ 9.4	- 3.1
Single Women			
62-64	- 2.5	+ 3.3	0
65-71	- 7.9	+ 7.6	- 0.9
72+	- 12.8	+ 9.0	- 3.5
Families			
62-64	- 3.7	+13.0	+ 1.9
65-71	- 6.9	+36.2	+10.3
72+	- 5.6	+40.6	+ 4.7

Source: Simulations produced by DRI-AARP Age-Income Model

TABLE 8

PERCENT CHANGE IN POVERTY RATES, 1980-1990

Single Men	Full COLA	CPI-3	.66 CPI
62-64	- 16.9	- 4.7	- 8.9
65-71	- 31.5	- 16.8	- 21.7
72+	- 28.6	+ 7.1	- 5.9
Single Women			
62-64	- 13.6	- 3.3	- 7.0
65-71	- 22.5	+ 4.4	- 4.1
72+	- 24.1	+ 12.2	- 0.3
Families			
62-46	- 16.6	+ 9.3	——
65-71	- 25.9	+ 39.7	+ 13.8
72+	- 46.9	+ 42.2	+ 6.2

Source: Simulations produced by DRI-AARP Age-Income Model

VFW
VETERANS OF FOREIGN WARS OF THE UNITED STATES
NATIONAL LEGISLATIVE SERVICE
Office of Director

STATEMENT OF

DONALD H. SCHWAB, DIRECTOR
NATIONAL LEGISLATIVE SERVICE
VETERANS OF FOREIGN WARS OF THE UNITED STATES

TO THE

COMMITTEE ON THE BUDGET
UNITED STATES SENATE

WITH RESPECT TO
THE FISCAL YEAR 1983 BUDGET FOR THE VETERANS ADMINISTRATION

WASHINGTON, DC MARCH 26, 1982

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

Thank you for the privilege of presenting to this distinguished Committee the views of the Veterans of Foreign Wars of the United States.

My name is Donald H. Schwab, and it is my privilege to serve the more than 1.9 million men and women of the Veterans of Foreign Wars as their National Legislative Director.

The Administration's proposed fiscal year 1983 budget for the Veterans Administration is $24.4 billion in outlays an increase of $222 million over 1982, but with proposed cost-savings of $328.6 million. It is 3.2 percent of the proposed federal budget, the least percentage in more than a decade although the veteran population standing at 30 million is the largest in the nation's history.

The VFW is, of course, pleased with the proposed increases of $530 million in medical care; $9.6 million in Medical and Prosthetic Research; $4.8 million for Memorial Affairs; $2 million in grants to state extended care facilities and the 8.1 percent cost-of-living increase in the Compensation, Dependency and Idemnity Compensation and Pension programs.

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As you are aware, Mr. Chairman, the proposed budget is in a state of flux. In its report to this Committee the Senate Veterans' Affairs Committee accepted only $150 million in proposed cost-savings; $70.7 million in specified savings and $79.3 in unspecified savings, rejecting major reductions in compensation and vocational rehabilitation. The House Veterans' Affairs Committee in its report to their Budget Committee accepted approximately the same dollar amount of cost-savings, but differs somewhat in the areas where cost-savings are proposed. However, these differences will be resolved. The primary concern of the VFW is that the basic integrity of the VA hospital and medical care system, the compensation program and the pension program remain in tact.

The VFW is concerned, Mr. Chairman, with the absence of funding or the under funding in certain areas. The expanded Geriatric Research and Care Program authorized by Public Law 96-330 was not funded in 1982, and again in 1983. Because of the rapidly growing population of older veterans, Congress recognized the need for expansion of this specialty and it should be fully funded. Another program authorized by Public Law 96-330 is the Veterans Administration Health Professional Scholarship Program. The physicians' portion has never been funded and only in this fiscal year 1982 has $4 million been appropriated for the Nurses' Scholarship Program. The critical shortage of registered nurses throughout the VA hospital system is well known and without the scholarship program it is simply not possible for the VA to compete with the private sector in the recruitment of registered nurses. Due to this shortage of nurses entire wards have been closed in some hospitals and 800 beds throughout the hospital system. Therefore, it is imparative that funding for the Nurses' Scholarship Program be included in the fiscal year 1983 budget and the budgets in years to follow if the shortage of registered nurses within the system is to be alleviated. In addition, we fear that the $17 million reduction in beneficiary travel will hurt most those veterans who can least afford any unusual expenditure. As you know, beneficiary travel in general is only paid when preauthorized unless the patient is hospitalized or treated. We are also concerned that the VA's Department of Medicine and Surgery is being required to absorb $58.6 million in 1982 in increases in staff stipends and in fiscal year 1983 that the Administration has requested only partial funding for the fiscal year 1982 employee health-benefits and wage-board increases.

Mr. Chairman, we of the VFW are aware of the cost-savings proposals submitted to this Committee by the Congressional Budget Office entitled "Reducing the Federal Deficit: Strategies and Options" to eliminate the pension program, eliminate compensation payments to veterans with service-connected disabilities rated less than 40 percent, close 30 VA hospitals and subject compensation benefits to federal income tax. We trust that the Administration will never renege on its commitment to our nation's veterans and transmit these proposals to Congress for serious consideration.

Mr. Chairman, considering the overall reductions in federal programs, we believe that the VA budget will be one with which we can live in good conscience with little change provided further reductions are not made.

Resolutions passed by the voting delegates to our 82nd National Convnetion with respect to the Veterans Administration Budget are appended to my testimony and are as follows:

Resolution No. 623 entitled, "Beneficiary Travel."

Resolution No. 717 entitled, "Matching Fund Construction Grants to States."

Resolution No. 740 entitled, "Oppose Reductions in VA Medical Facilities and Closures of VA Regional Offices."

Resolution No. 747 entitled, "Scholarship to Train VA Medical Doctors."

Resolution No. 775 entitled, "The VA Budget and Reconciliation."

Resolution No. 779 entitled, "Cost-of-living Increase for VA Beneficiaries."

Resolution No. 781 entitled, "Support Legislation to Improve VA Delivery of Geriatric and Extended Health Care Services."

The VFW appreciates the tremendous task facing this Committee and we wishe you well in your deliberations. Thank You.

Resolution No. 623

BENEFICIARY TRAVEL

WHEREAS, all eligible veterans have been receiving beneficiary travel pay to defray the expenses incurred when traveling to and from VA facilities in conjunction with medical treatment and authorized examinations; and

WHEREAS, beneficiary travel pay has not maintained parity with inflationary transporation costs; and

WHEREAS, it has been proposed that the payment of beneficiary travel be geared to a $5 deductible for each hospital or clinic visit for non-service connected veterans; and

WHEREAS, since a high percentage of beneficiaries in this category are seriously disadvantaged ecomonically, such a proposal would create a worsening of an already existent financial hardship preventing them from seeking necessary medical care until their health deteriorates requiring more expensive hospitalization or long-term rehabilitation; now, therefore

BE IT RESOLVED, that the 82nd National Convention of the Veterans of Foreign Wars of the United States, vigorously and forcefully resist any and all efforts to change payment of beneficiary travel from the formula now being utilized.

Adopted by the 82nd National Convention of the Veterans of Foreign Wars of the United States held in Philadelphia, Pennsylvania, August 14-20, 1981.

Resolution No. 623

Resolution No. 717

MATCHING FUND CONSTRUCTION GRANTS TO STATES

WHEREAS, the Congress of the United States has continuously provided medical, domiciliary, and nursing care to the nation's veterans; and

WHEREAS, the Veterans Administration has worked with many states to develop hospital, domiciliary, and nursing care facilities to provide care for the veterans; and

WHEREAS, many of the states with financial support from the Veterans Administration have provided hospital, domiciliary, and nursing care to veterans in cooperation with the Veterans Administrations; and

WHEREAS, there is a continued need to provide nursing care to the nation's veterans above and beyond the level that can be provided by individual states or the federal government, however, in a joint venture these services can be expanded to the older veterans; now, therefore

BE IT RESOLVED, by the 82nd National Convention of the Veterans of Foreign Wars of the United States, that we go on record requesting the Congress to provide increased funding to the Veterans Administration for the purpose of matching state funds to expand the state veterans hospital, domiciliary, and nursing care services; and

BE IT FURTHER RESOLVED, that the Veterans Administration shall negotiate from time to time the Veterans Administration reimbursement costs to states for care of such eligible veterans.

Adopted by the 82nd National Convention of the Veterans of Foreign Wars of the United States held in Philadelphia, Pennsylvania, August 14-20, 1981.

Resolution No. 717

Resolution No. 740

OPPOSE REDUCTIONS IN VA MEDICAL FACILITIES AND CLOSURES OF VA REGIONAL OFFICES

WHEREAS, the Reagan administration has proposed drastic reductions in the Veterans Administration 1982 budget above and beyond the previous proposed Carter budget; and

WHEREAS, the proposal provides for the delay in construction, reductions in beds and in some instances, total closing of VA medical facilities, and

WHEREAS, the proposed reductions in funds will not only cause the closing of beds, but will reduce medical services to the nation's war veterans; and

WHEREAS, the need for medical services continues to increase due to the advancing age of the World War II veterans; now, therefore

BE IT RESOLVED, by the 82nd National Convention of the Veterans of Foreign Wars of the United States, that we go on record opposing the administration's proposed cut in the Veterans Administration budget and the reduction of services to the nation's war veterans, including the proposal to eliminate or delay construction of medical facilities and closing of State VA offices; and

BE IT FURTHER RESOLVED, that we petition members of the Congress to oppose the planned reductions in VA medical facilities that would eliminate or curtail medical services to the nation's war veterans and vigorously oppose the closing of the VA Regional Office in each of the states and to hold President Reagan to his campaign promise to not reduce any veterans benefit and to provide the necessary funding for those programs.

Adopted by the 82nd National Convention of the Veterans of Foreign Wars of the United States held in Philadelphia, Pennsylvania, August 14-20, 1981.

Resolution No. 740

Resolution No. 747

SCHOLARSHIP TO TRAIN VA MEDICAL DOCTORS

WHEREAS, the Congress of the United States has recently approved a scholarhip program to train medical doctors who would in return be required to re-pay this nation with a specified time period of service in the Veterans Administration hospital system upon completion of their training; and

WHEREAS, this nation has traditionally and successfully utilized a similar arrangement with the personnel who had completed military training in our Service Academies for the Army, the Navy, Coast Guard, the Air Corps and the Marine Corps; and

WHEREAS, the Federal Office of Management and Budget has not yet provided any funds in its budgetary request to begin and to maintain such a training program, now therefore

BE IT RESOLVED, by the 82nd National Convention of the Veterans of Foreign Wars of the United States, that we petition the President of the United States to direct the Office of Management and Budget to budget adequate funding in subsequent years to provide for the Congressionally approved scholarship program to train medical doctors who, upon completion of training, would agree to serve, in paid employment, in the Veterans Administration hospital system for a minimum specified period of time.

Adopted by the 82nd National Convention of the Veterans of Foreign Wars of the United States held in Philadelphia, Pennsylvania, August 14-20, 1981.

Resolution No. 747

Resolution No. 775

THE VA BUDGET AND RECONCILIATION

WHEREAS, the current veteran population of 30 million is the largest in the history of our nation; and

WHEREAS, the VA portion of the federal budget has fallen from 5 percent in outlays in 1975 to 3.4 percent for the fiscal year 1982; and

WHEREAS, veterans are being denied needed health-care due to budgetary and personnel constraints; and

WHEREAS, the Reconciliation Act of 1981 eliminated the $300 VA burial benefit for our nation's 27 million veterans who are not in receipt of compensation or pension and eliminated and curtailed benefits for Vietnam veterans; and

WHEREAS, veterans who served honorably in our armed forces during periods of war and hostility have rendered a very special service to our great nation; now therefore

BE IT RESOLVED, by the 82nd National Convention of the Veterans of Foreign Wars of the United States, that we prevail upon the Congress of the United States to pass a budget for the Veterans Administration which will fully fund the benefit programs and the VA hospital and medical care system to include allowances for inflation; and

BE IT FURTHER RESOLVED, that although we fully support the President's attempt to right the economy by the elimination of fat, fraud and waste within the VA, further cuts cannot be made in ongoing programs in reconciliation of the fiscal year 1983 budget without doing violence to either existing benefits or the hospital and medical care system or both.

Adopted by the 82nd National Convention of the Veterans of Foreign Wars of the United States, held in Philadelphia, Pennsylvania, August 14-20, 1981.

Resolution No. 775

Resolution No. 779

COST-OF-LIVING INCREASE FOR VA BENEFICIARIES

WHEREAS, payments to VA beneficiaries have continued to be eroded by inflation; and

WHEREAS, many of those in receipt of these benefits are on limited or fixed income; and

WHEREAS, many other segments of society have a greater opportunity to increase their incomes whereby they are not so adversely effected by those increases; now, therefore

BE IT RESOLVED, by the 82nd National Convention of the Veterans of Foreign Wars of the United States, that we urge Congress to enact legislation that will provide annual increases in an amount at least commensurate with the Consumer Price Index for all Veterans Administration beneficiaries.

Adopted by the 82nd National Convention of the Veterans of Foreign Wars of the United States held in Philadelphia, Pennsylvania, August 14-20, 1981.

Resolution No. 779

Resolution No. 781

SUPPORT LEGISLATION TO IMPROVE VA DELIVERY OF GERIATRIC AND EXTENDED HEALTH CARE SERVICES

WHEREAS, the demand for geriatric and extended health care and medical services being placed upon the VA is rapidly increasing; and

WHEREAS, by 1980, there will be nearly 3 million veterans 65 years of age or older; by 1985, there will be almost 5 million such veterans; and by 1990, this figure is projected to jump to over 7 million veterans 65 years of age or older; and

WHEREAS, the VA has instituted a Geriatric Research, Education and Clinical Centers Program (GRECC), to "... give visibility and respectibility to geriatrics and, by creating centers of interest and activity, exploit available old resources and develop enthusiastic new practitioners, teachers, and researchers in the field;" and

WHEREAS, the VA hospital system should be the leader in geriatric research, training, and care, due to the extensive network of VA facilities and the scope of medical care now provided; now, therefore

BE IT RESOLVED, by the 82nd National Convention of the Veterans of Foreign Wars of the United States, that we go on record and urge the expansion of the VA's role in the delivery of geriatric health care service to meet head-on the documented need of such health care services.

Adopted by the 82nd National Convention of the Veterans of Foreign Wars of the United States held in Philadelphia, Pennsylvania, August 14-20, 1981

Resolution No. 781

STATEMENT OF
CHARLES E. JOECKEL, JR.
DEPUTY NATIONAL LEGISLATIVE DIRECTOR
DISABLED AMERICAN VETERANS
TO THE
SENATE BUDGET COMMITTEE
APRIL 1, 1982

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

On behalf of the 700,000 members of the Disabled American Veterans I am pleased to appear here today to discuss the budget request of the Veterans Administration for Fiscal Year 1983.

Let me begin, Mr. Chairman, by thanking you and the members of the Committee for soliciting our input on the Fiscal Year 1983 VA budget. Today, we will address some of the 1983 budget highlights and comment on the legislative proposals contained in the request.

Mr. Chairman, although outlays for the Veterans Administration are projected to rise by less than 1% in Fiscal Year 1983, this budget, in many ways, attempts to deal with many of the shortfalls in funding that have occurred in the VA over the past several years..

I refer, of course, Mr. Chairman, to the fact that the VA health care budget is up by some $530 million over Fiscal Year 1982 and to the $137.2 million increase in the Construction Program. We are not yet prepared to say that the Office of Management and Budget has clearly demonstrated its support for the maintenance of a separate system of health care for veterans, but we can say, at least, that, in terms of the federal budget crisis today, we believe the Administration has dealt fairly with the VA Hospital and Medical Care Program.

MEDICAL CARE

Mr. Chairman, we note on Page 6-15 in Volume II of the detailed text of the Fiscal Year 1983 budget proposal that the Veterans Administration's request for Beneficiary Travel is $24.7 million less than the 1982 level. Despite assurances, we are deeply concerned over how such a reduction might impact upon service-connected disabled veterans.

We believe that if the Administration intends to restrict the payment of Beneficiary Travel, then the correct course of action should be taken--that is, to submit legislation outlining the proposal to achieve this cost-savings. Simply under-funding the travel reimbursement account and parceling out funds in a piecemeal fashion leaves no assurance that veterans entitled to the benefit will actually receive it or that the program will be administered fairly and equitably.

Secondly, we find that no funds have been requested to implement the Nurse Scholarship Program authorized by the enactment of Public Law 96-330. As you know, the Congress appropriated $4 million for this program in Fiscal Year 1982 (P.L. 97-101). The absence of these funds in the 1983 budget poses a very difficult problem for the Department of Medicine and Surgery.

Fiscal Year 1982 appropriations will allow the VA to grant scholarship funds to approximately 300 nurses this year. However, training and the achievement of a Degree under a nursing program requires a two year commitment. Accordingly, if funding is not provided in Fiscal Year 1983, the VA, of course, will be unable to meet its obligations under nurse scholarship contracts--therefore, losing both the prior funding and the newly trained nurses' two year commitment to the VA Health Care Program.

For these reasons and others, we would respectfully request that the Committee include in the First Concurrent Resolution on the Budget for FY 1983, funding at the current level for the VA Nurse Scholarship Program.

The DAV is opposed to the $2.5 million VA request to fund feasibility studies for the contracting out of certain functions currently performed by federal employees within the Department of Medicine and Surgery ($2 million) and for the implementation of a "user's fee" in connection with the care and treatment provided to nonservice-connected veterans not in receipt of VA pensions ($500,000).

As you know, we have already expressed our views concerning the implementation of OMB Circular A-76 with respect to the VA Department of Medicine and Surgery. Frankly, the DAV has no objection to contracting certain minor functions such as general grounds maintenance. However, because of our belief that the contracting out of certain health related functions would adversely impact upon the quality of care provided to veterans, our organization would continue to oppose any contracting of direct or indirect health care services--even if the studies were completed.

Further, Mr. Chairman, should veterans be charged a fee for services rendered and benefits provided by the Veterans Administration? This is the question raised by the Administration's request for $500,000 to study the feasibility of imposing a user's fee upon the health care provided to nonservice-connected veterans and by a legislative proposal contained in the 1983 budget request to charge a .5% origination fee in the VA Home Loan Guaranty Program.

Mr. Chairman, the VA already has authority contained in Public Law 96-330 to limit the treatment of nonservice-connected veterans in VA facilities to only those nonservice-connected veterans who can demonstrate, in fact, that they are unable to defray the expense of such care if it were provided in a private medical facility. Therefore, it seems, that the VA would only be assessing a fee upon veterans already known to be unable to afford health care anywhere else.

We would not argue that the assessment of a nominal fee would result in the failure of a veteran to receive such care and treatment. But we would argue, that as the federal deficit rises so would the irresistible urge to increase the fee well beyond the definition of nominal.

The same could be said about the proposal which would assess a similar fee in the VA Home Loan Guaranty Program. Unlike the health care user's fee, however, the Administration would charge both service-connected and nonservice-connected veterans for the use of their loan guaranty benefits. Frankly, Mr. Chairman, the DAV is opposed to the concept of charging veterans for the benefits they have earned and, it seems to us, at least, that service-connected disabled veterans have already paid the price.

ADMINISTRATION'S LEGISLATIVE PROPOSALS

As I stated earlier, Mr. Chairman, the DAV is pleased with most of the funding levels provided in the Fiscal Year 1983 VA budget request. We are surprised, however, that the Administration, in order to keep the growth of the VA budget in check, has placed a disproportionate share of this burden upon service-connected disabled veterans. Some $165.4 million of the $233.6 million in cost-savings proposals contained in the budget would directly impact upon the benefits provided to service-connected disabled veterans.

Mr. Chairman, three years ago, in discussing the passage of the measure which eventually became Public Law 95-479, the following assessment was made to justify the extension of dependency allowance payments to service-connected veterans rated 30% and 40% disabled:

> We carefully considered...the amount of other income support available to disabled veterans with dependents, such as Social Security Disability payments. We also examined the rationale behind the House action extending prorated dependents' allowances to veterans with 40% disability ratings, that is, that veterans with disabilities rated at 40% may have substantial impairments of earning capacity and needs for additional income support for their dependents.
>
> On the basis of these considerations...we agreed on...the prorated dependents' allowances to veterans rated 30% disabled as well as those rated 40% disabled. The extension of such allowances to 30% disabled veterans was based on the view that the justification for the extension to such veterans was comparable to that for 40% disabled veterans.

Mr. Chairman, two of the legislative proposals contained in the Fiscal Year 1983 VA budget request would eliminate the payment of dependency allowances under the compensation program for service-connected veterans rated 30% and 40% disabled and terminate the payment of additional subsistence allowances under

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the Vocational Rehabilitation Program for service-connected veterans with dependents. The Disabled American Veterans is strongly opposed to the enactment of this legislation.

We note that in its document entitled: Major Themes and Additional Budget Details, the Office of Management and Budget chose to describe the disabilities in the 30% and 40% categories as, "relatively minor...such as, flat feet, severe chronic laryngitis, severe convulsive tic or a moderate ulcer."

We would point out, Mr. Chairman, that a 30% or 40% evaluation is assigned for disabilities, such as, the amputation of a lower extremity below the knee, the anatomical loss of one eye, and an injury to the skull resulting in a hole larger than the size of a quarter (25¢). Generally, these disabilities are combat related and cannot be described as relatively minor.

The concurrent enactment of these two proposals would have a drastic impact upon the monetary support provided by the Veterans Administration to service-connected veterans who are rated 30% and 40% disabled and who are training under the Vocational Rehabilitation Program. For example, a 30% veteran with a spouse and two children who is attending school, would stand to lose 32% of the VA payments currently provided; if the same veteran had three children, the reduction in VA support would be 36%.

Similarly situated veterans evaluated at 40% would lose 30% in VA benefits for the support of a spouse and two children and 34% in overall payments if the veteran has a spouse and three children.

Mr. Chairman, these are not, in our view, slight modifications in the benefits provided to service-connected veterans with relatively minor disabilities. We, therefore, strongly urge the Committee to support the restoration of $165.4 million in the Fiscal Year 1983 budget to maintain the current levels of dependency allowance payments provided to service-connected veterans rated 30% and 40% disabled and to service-connected veterans training under the Vocational Rehabilitation Program.

We note also that no funding is provided in the FY 1983 VA budget to implement Section 302 of Public Law 97-72 to establish a Small Business Loan Program for Vietnam Era and certain service-connected disabled veterans.

We do know, however, Mr. Chairman, that the current procedures to give extra consideration to Vietnam Era and disabled veterans by the Small Business Administration are not working— thus, the Congress enacted legislation initiated by this Committee which created a new program within the Veterans Administration.

We support and would urge the Committee to recommend full funding of the VA Small Business Loan Program at the level authorized in Public Law 97-72.

When considering the various cost-savings proposals contained in the President's budget...the assessment of a .5% origination fee in the VA Home Loan Guaranty Program, elimination of dependency allowances for service-connected veterans rated at 30% and 40% disabled, to reduce subsistence allowances paid to veterans with dependents under the Vocational Rehabilitation Program and the failure to fund the Small Business Loan provisions of Public Law 97-72...it can be said that these reductions have their greatest impact on younger veterans who seek to buy homes, who have dependent children, who are attending school and who need special assistance in establishing a business.

VETERANS AFFAIRS COMMITTEES' RECOMMENDATIONS

As you know, Mr. Chairman, both Veterans Affairs Committees have rejected some $228 million in cost-savings proposals contained in the President's Fiscal Year 1983 budget request. The two Committees have requested the restoration of funding for virtually all the Administration's proposed reductions in the benefits provided to service-connected disabled veterans.

Their recommendations to you and your counterpart in the other body, call for a reduction in entitlement spending of approximately $150 million in Fiscal Year 1983. These savings would be achieved by making adjustments in the benefits provided to nonservice-connected veterans--adjustments which in the Committees' views have the least impact upon sick and indigent nonservice-connected veterans and no impact upon service-connected disabled veterans and their families.

While the DAV certainly does not support reductions in VA programs, considering the economic crisis that affects all federal agencies, we do not object to the overall dollar amount ($150 million) of savings proposed by the House and Senate Veterans Affairs Committees. In addition, Mr. Chairman, I would point out that even though we disagree in part with the manner in which some of these savings would be achieved, we can support the Veterans Affairs Committees' Fiscal Year 1983 budget recommendations.

Accordingly, we respectfully request that you adopt, as part of the First Concurrent Resolution on the Budget for Fiscal Year 1983, the funding recommendations for the Veterans Administration as proposed by the Veterans Affairs Committee.

PROJECTED OUT-YEAR SAVINGS

We note, Mr. Chairman, that the President has proposed as a part of the Fiscal Year 1983 budget for the VA a legislative cost-savings measure designed to reduce spending in the out-years, specifically 1984 and beyond.

I refer, of course, to the Administration's proposal to offset dollar-for-dollar benefits received by certain totally disabled service-connected veterans "who are rated between 60 and 90% disabled and are judged to be unemployable" by the amount they receive in Social Security or other federal retirement payments. Although this measure would not become effective until Fiscal Year 1984, the Administration seeks the enactment of the legislation this year and has incorporated the proposal into the Fiscal Year 1983 VA compensation increase bill.

As we pointed out in testimony on a similar proposal last year, the concept of offsetting these payments fails to recognize the separate and distinct eligibility criteria of VA, Social Security and federal retirement benefits. These payments are earned benefits, based upon prior wages and contributions--whether or not the benefits provided are based upon disability or old age. The fact that the system happens to be administered by the federal government, is no reason to treat Social Security and federal retirement benefits any differently than a private insurance policy or private pension plan.

As you may know, Mr. Chairman, both Veterans Affairs Committees have indicated in their budget recommendations that they do not plan to act upon such legislation. Accordingly, we respectfully request that the Budget Committee reject the projected out-year savings, based upon the offset of VA unemployability benefits by payments of Social Security or federal retirement payments and restore these funds in Fiscal Year 1984 and in the out-year projections.

Again, Mr. Chairman, I wish to thank you for allowing us this opportunity to express some of our concerns regarding the VA budget request for Fiscal Year 1983.

The Testimony of
GREATER WASHINGTON ORGANIZATIONS
FOR GOVERNMENT FUNDING OF SOCIAL SERVICES
on the
SOCIAL SERVICES PORTION
of the
ADMINISTRATION'S PROPOSED BUDGET
FOR FISCAL YEAR 1983

Presented to the
COMMITTEES ON THE BUDGET
of the
UNITED STATES HOUSE OF REPRESENTATIVES
and the
UNITED STATES SENATE

April 2, 1982

Washington is not merely the seat of Federal government. The District of Columbia and the Maryland and Virginia suburbs comprise a community of three million people. Like many large cities, the District has a lot of poor citizens. The people living in the suburban jurisdictions are generally more affluent, but in every part of the Washington Area there are ill and disabled people, students, and children. All of these populations are hurt by the reductions in social service programs proposed in the Administration's Fiscal Year 1983 budget.

The total loss of Federal social service funding in FY '83 estimated by seven of the 12 local budget offices (each of the six jurisdictions has a separate budget office for its school system) is $41.3 million. Of that total, $12.8 million is to be cut from four school districts.

The services that would be lost are many; the potential harm is great. But because not all of the jurisdictions have made estimates at this early date, and some budget offices have predicted funding levels for programs that other offices have not addressed in their predictions, all of the figures used are only part of the total, and should be viewed as absolute--and indecently large--minimums.

Aid to Families with Dependent Children, which mostly helps young women and their small children, will be a $9.1 million-smaller program in Washington under the present budget plan. The Women, Infants, and Children program, which provides nutritious foods for pregnant and lactating women, and for babies and young children, will lose $3 million. The Washington Metropolitan Area will have 4.1 million fewer dollars for its Comprehensive Employment and Training Act programs, which primarily teach marketable job skills to people on welfare. The social services block grant will be $3 million less this year than last; programs that prevent child abuse, provide day care, and aid the elderly will all suffer. Greater Washington will receive $5.2 million less from

Community Services Block Grants, which provide money to fight the cause of poverty through job-creation and other programs. The Community Development Block Grants will be half a million dollars short of last year's allocation, so fewer homes for the poor will be built or rehabilitated.

Education is being forced into decline by the cuts in Federal aid. Impact Aid, the money the Federal Government pays localities to educate the children of military families, who don't pay local taxes, is being reduced by $4.6 million. This will result in fewer teachers. Chapter I, formerly Title I, provides money that school districts use in different ways to help poor children, such as providing supplemental reading programs. Chapter I money to the Washington Area will be cut by $5.6 million. Handicapped students receive the extra help they need through special education funding, but that funding will be cut by $800 thousand. School breakfast and school lunch programs in the Washington Metropolitan Area will also lose $800 thousand, so more children will be hungry and weak and less able to learn.

In addition to the area-wide cuts already described, the local jurisdictions will absorb the following individual reductions.

The District of Columbia will lose a million dollars in Low Income Energy Assistance, which means more poor people will be cold in winter. Arlington County (Va.) will receive $140 thousand less for day care programs and for the Head Start program, which gives poor children a better chance to succeed in school by giving them pre-school training and experience. Alexandria (Va.) will get $150 thousand less from the Law Enforcement Assistance Administration--a cut that will hurt police protection in the city. Arlington County, which has a large and growing Indochinese refugee population, will lose $470 thousand in bilingual-education aid to its schools. Fairfax County (Va.) schools will lose $400 thousand in Indochinese refugee assistance.

Again, these are incomplete and preliminary figures. But they give a taste of the results of budget cuts, and the taste is bitter. The same effects are being felt across America, but this is how the people living in and around the Capital will feel them. The Congress lives here and can see what past cuts have done and what new ones will do unless they are stopped. The Committee on the Budget should restore full funding of social services in the budget of the United States for Fiscal Year 1983.

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The Washington Teachers Union
The Washington Urban League
Wider Opportunities for Women

STATEMENT OF THE ASSOCIATION FOR THE ADVANCEMENT OF PSYCHOLOGY

The FY 1983 Administration budget proposes to terminate programs which have provided roughly half of the financial support for students in our nation's graduate schools. Included in these terminations is the cessation of all funding for the NIMH Clinical Training Program which is the only program specifically supporting graduate students in psychology, psychiatry, psychiatric social work and psychiatric nursing.

Great attention and publicity has focused on the elimination of graduate student support from the student loans program. We feel certain that Congress understands the importance of graduate education and the extent to which it contributes to the United States' world leadership in science and scholarship.

We are also concerned that the Budget Committees may overlook the NIMH Clinical Training budget which is authorized under Sec.303 of the Public Health Service Act (42 USC 242a) and request that it be funded in the budget at the FY 1982 level of $42.2 million.

CLINICAL TRAINING

Support for clinical training from NIMH amounted to $61.9 million in fiscal year 1981. This figure decreased to $42.2 million in FY '82, and the FY '83 proposal would eliminate it entirely. Psychology generally receives 15% to 20% of the annual expenditure for clinical training; these funds support about 900 trainees at the present time. About $2 million of the NIMH clinical training funds have been targeted specifically for ethnic minority groups. Elimination of the overall clinical training program will terminate funding for the highly successful American Psychological Association Minority Fellowship Programs (and the parallel programs administered by other mental health professional associations).

NIMH clinical training grants in psychology provide a particularly cost effective method for training health service providers, and they include accountability mechanisms. Approximately 80% of funds in psychology clinical training grants go into student stipends, and these trainees must pay back this support by later working in areas and facilities where shortages of various types exist.

The rationale for the elimination of these funds given in 1981 by the Director of the Office of Management and Budget (OMB), David Stockman, was that "the supply of mental health professionals is now generally adequate, mental health professionals generally have good income potential, and thus federal subsidies for such training are no longer necessary." While it is true that the supply of mental health professionals has increased, it is not necessarily true that the "supply is adequate." Indeed, Congress took issue with this statement in the 1981 appropriations process in the FY '82 budget and directed the HHS Secretary to provide some funds for new awards in areas of greatest need.

The rationale for the elimination of these funds in 1982 is that "training opportunities exist today which were not available when the program began 30 years ago." The specific opportunities which exist today are not mentioned, nor are they apparent, since the other major source of graduate student support, Guaranteed Student Loans, are being eliminated simultaneously.

STUDENT LOANS

Graduate students will not be eligible for guaranteed student loans after April 1, 1982. That program allows students with family income of less that $30,000 to borrow money at 9% interest. Interest is forgiven and payment on principal is deferred while a student is in school. Repayment begins after the borrower leaves school. At present some 600,000 graduate students--over half of all graduate enrollment in all disciplines--depend on guaranteed student loans to finance their education. A large number may be unable to continue if the Administration's recommendations are adopted.

Graduate students would still be eligible, however, for Auxiliary Loans to Assist Students (ALAS). These loans carry a 14% interest rate, and the student must repay interest while in school. (If a student is part-time, she/he must repay interest *and* principal while in school.) Presently ALAS loans are only operational in 14 states, and only 5% of loans to date have been made directly to self-supporting students (with the bulk of loans made to the parents of students). According to the *Chronicle of Higher Education*, banks appear to be reluctant to make ALAS loans to graduate students, since the absence of the in-school interest subsidy necessitates frequent billing of students.

ALAS loans will not help many students. For example, if a student borrows $8,000 per year for each of the four years of a doctoral program and repaid the loan over a ten year period after graduation at a 14% interest rate, the payments would total $59,542. The retirement of the 14% loan would require a *monthly* payment of $496.85 over ten years plus payment of interest while a student. A person earning $20,000 per year receives $1667 per month *before taxes*. Thus about *one-third* of the average salary of a clinical psychologist just out of school would go to pay off the school-incurred debt. And this example ignores the higher cost of many schools, and the fact that only a minority of clinical students can finish a degree in four years. It seems clear that few people could afford this kind of investment.

COLLEGE WORK-STUDY PROGRAM

The College-Work Study Program helps some graduate students to pay some of their educational expenses through part-time, career-relevant employment. The Council of Graduate Schools in the United States estimates that 50,000 graduate students were employed in 1981 through this program. The Administration is asking that $44 million be cut from the $528 million already allocated for this program for the 1982-83 academic year; the Administration wants to further reduce this program to $397.7 million for 1983-84. This drop of about 27 percent in funding translates into a loss of approximately 13,500 jobs for graduate students.

At present the outlook for graduate education in psychology is particularly bleak. About one-third of graduate student support is provided by the institution in which the student is enrolled. This support is generally in the form of teaching assistantships and other services to the institute. The other two-thirds of the support is derived from research assistantships, from training grants, and from self-support--particularly guaranteed student loans. Research assistantships will be increasingly scarce given the major research funding cuts for social and behavioral sciences at NIMH, NIE, and NSF. Funds for research training are down at NIMH and much of the science education budget at NSF is due to be cut. If clinical training grants and guaranteed student loans are eliminated, all of the students cut from these programs will be competing for the increasingly scarce research funds.

It is clear that students will be loathe to emcumber themselves with huge long-term debts accumulated through the ALAS program, or through the Health Education Assistance Loan (HEAL) program (for which clinical psychology students are now eligible). So who will be our graduate students? Only those with sufficient wealth to support their own education. The equal opportunity for all strata of society so carefully developed over the past 20 years will be reversed and the social and ethnic diversity so important to the field will disappear.

We urge you to respond to these concerns.

STATEMENT

of

FLETCHER L. BYROM

Chairman, Committee for Economic Development
and
Chairman, Koppers Company, Inc.

to the

COMMITTEE ON THE BUDGET

UNITED STATES SENATE

March 19, 1982

My name is Fletcher L. Byrom. I am Chairman of the Koppers Company and also of the Committee for Economic Development, an organization which is composed of 200 leading business executives and educators. I appreciate the opportunity to appear before you to discuss key economic policy issues that confront our nation today.

CED was founded just forty years ago, at a time when there were widespread fears that the end of World War II would bring a major economic downturn. The founders of CED were convinced that there was nothing inevitable about this. They believed -- correctly -- that with proper economic policies, both the U.S. and the world economy could experience steady economic growth and high employment, based fundamentally on the productive strengths of the private enterprise system. To achieve this result, however, they argued it was essential that short-run fiscal, monetary and other economic policies be systematically and steadily geared to the nation's broad long-range economic goals. This emphasis has been a central feature of CED's thinking ever since.

There are some definite parallels to that earlier situation today, though I would certainly not want to drive the analogy too far. Our economy currently has an exceptional opportunity to embark on a sustained period of economic growth, based primarily on increased private capital investment and restoration of the U.S. competitive position. In the last several years, a growing national consensus has finally emerged that inflation must be brought under firm control; that the progressive liquidation of the capital base of our nation's economic system had to be halted; and that greater reliance needs to be placed on competitive market forces. Yet progress in these directions is now being seriously impeded by the high level of interest rates that is significantly related to the enormous prospective budget deficits and by the continuation of economic slack in this high-interest rate environment. These conditions are swamping the potential favorable effects on investment of recent policy changes, including particularly the major improvements in capital recovery allowances instituted last year.

There is now growing appreciation that without major further action, the budget deficit will not only rise well above the hundred billion dollar mark in 1983 but will show successive yearly increases thereafter. This must simply not be allowed to happen -- and both the markets and the public need to receive clear indications soon that it will not happen. It is imperative that early and convincing action be taken to reduce the magnitude and change the direction of these deficits to levels that are consistent with lower interest rates and sound economic recovery. A downward trend in these deficits must be clearly demonstrated and confidence built that such a trend will be sustained.

What I particularly want to stress here, however, is the importance of approaching the task of reducing the deficit in a way that is consistent with key long-term goals for the economy. Let me comment briefly on four of these goals that we regard as centrally important.

First, there is need for a progressive, year-by-year reduction in the inflation rate until essential price stability is achieved. The recent sharp deceleration in the rise of the Consumer Price Index is of course very gratifying. It would be a mistake, however, if we were to declare victory over inflation prematurely. As the chart attached to my testimony shows, the overall inflation rate has dropped significantly in all recent recessions, only to show a more pronounced rise in each recovery phase. There are strong reasons for believing that we are now witnessing more permanent progress toward bringing down the underlying inflation rate. The trend in various recent labor agreements toward more emphasis on labor-management cooperation to achieve greater productivity is particularly encouraging in that connection. But adequate progress toward the goal of reducing inflation cannot be taken for granted and fiscal and monetary policies, in particular, must be conducted on the assumption that inflationary risks remain great.

A second central policy aim is the achievement of healthy economic growth and high employment. Given the continuing inflationary threat, some moderation in the rate of long-term economic growth from what otherwise might have been desirable is probably necessary. But demand restraint must not become so severe that it blocks out necessary incentives for capital formation and productivity growth.[1/]

[1/] See CED's 1980 policy statement, Fighting Inflation and Rebuilding a Sound Economy, p.11

Third, public policies need to be redirected so that a significantly greater share of the growing real Gross National Product will be devoted to investment and saving. We need more investment not only in new plant and equipment but also in more rapid technological progress and innovation, in domestic energy production and conservation, in improved skill training and education, and in public infrastructure.

Fourth, for reasons of both equity and humanity, national policy can and should give adequate weight to the concerns of those disadvantaged members of our society who have the greatest need.

Let me now outline the kind of approach toward reducing the deficit that, I believe, would adequately balance the various goals I have cited. While the specifics of this appraoch are my own, they are largely in line with positions that CED has supported in the past. On the basis of an informal check with other CED trustees, I also believe that they would have wide support within our organization.

1. The total reduction in the projected deficit must be adequate to make a major dent in existing inflationary expectations and reduce pressures on interest rates and financial markets sufficiantly to allow for a major revival of capital investment.

2. Given the magnitude of the required cuts, no major segment of the budget should be excluded from consideration. Defense spending should be subjected to the same intensive scrutiny that has been applied to non-defense programs. This should permit significant savings from projected increases, at least by fiscal years 1984 and 1985, without any

weakening in our basic defense posture. Better-honed strategies, plus improved procurement and pre-purchase planning ought to enable us to get more for our money. Such careful scrutiny of defense spending can strengthen our defense posture, because a strong economy is in itself a key ingredient of U.S. overall national security.

3. In the non-defense area, an important part of budgetary savings should come from slowdowns in the indexed growth of entitlement programs, including Social Security, which have been adjusted annually on the basis of the Consumer Price Index or some roughly equivalent index to take account of inflation. It would be neither realistic nor equitable to concentrate the principal burden of budget cuts on a narrower range of social programs, particularly those that were already subjected to heavy cuts last year. Indexed entitlement programs now constitute more than one-third of the total federal budget and an even larger portion of the non-defense budget. Adjustments to take account of inflation for these programs have considerably exceeded the increase in average wages in the past few years.

On grounds of equity, therefore, there is a strong case for linking future increases in Social Security and other entitlement benefits to average wage increases rather than the rise in consumer prices whenever average wage increases are less than the consumer price rise. CED's Research and Policy Committee specifically endorsed such an approach with respect to Social Security in its statement on retirement policy.1/ However,

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1/ See CED policy statement, Reforming Retirement Policies, September 1981, p.9

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while this rule would have produced important budgetary savings in the past few years, it cannot be counted on to produce savings in the next few years. Most current forecasts suggest that the rise in average wages will exceed increases in the Consumer Price Index, in line with more normal past patterns.

Hence, a number of other possibilities should be considered if budgetary savings are to be achieved through a slowdown in the indexed growth of entitlement programs. As we indicated in our statement on retirement policy last year, indexing of Social Security benefits at less than 100 percent for a period of several years would be equitable simply to correct in part for past increases in Social Security benefits in excess of average increases in wage rates.

One way to accomplish this purpose would be a one-year or fifteen month moratorium on cost-of-living adjustments for all entitlement programs, starting this July and extending until either July 1983 or the end of the fiscal year in September 1983. According to the Congressional Budget Office, this would yield annual budget savings of $18 billion by FY 1983 and $22 billion by FY 1985. About three-quarters of these savings would come from Social Security. Another option would be to combine such a one-year or fifteen-month moratorium for all entitlement programs with allowing cost-of-living adjustments in subsequent years only for CPI increases in excess of 3 percent. By 1985, this combination (assuming a one-year moratorium) would produce an annual saving of $38 billion. A third option might be to start this July with the practice of basing cost-of-living adjustments on the rise in the CPI less three percentage points, yielding estimated savings of about $7 billion in FY 1983 and $24 billion in FY 1985.[1/] In connection with all of these options, some exceptions to the rule for less-than-full indexing may be desirable to aid persons in the lowest income categories.

4. Budgetary savings in other programs are undoubtedly possible, in part through greater management efficiency. Care must be taken, however that essential social safety nets are in fact preserved. Moreover, in various programs such as those concerned with longer-term investment in productive plant and equipment and also in human resources, some budgetary cutbacks would actually be counterproductive in terms of the longer-range objectives I have outlined. I consider it particularly important, for example, that adequate funds be allocated for training the hard-to-employ, provided these programs are properly designed. Similarly, while I see a need for tightening up on student loan programs at both the college and graduate levels, I believe that overly drastic cuts in this area would run counter to the national need for more adequate investment in the kind of education and training that our workforce will need to be able to meet the requirements of the coming decades.

5. Even with a generous estimate of the savings that can be achieved through the measures I have recommended on the expenditure side

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[1/] Still another option: holding cost-of-living adjustments to 85 percent of the rise in the CPI. Estimated savings: about $3 billion a year in FY 1983 and $9 billion in 1985.

of the budget, it is clear that a substantial contribution will also have to come from the revenue side if the overall deficit is to be brought down to manageable proportions.

6. A number of reasonable increases on the revenue side of the budget should be possible that would not interfere with achieving the long-run goals I have cited. In general, tax increases that fall on consumption, whether it be personal or business, are to be preferred. Some of these increases can be brought about by greater reliance on user taxes, as proposed by the Administration. Also, serious consideration should be given to increasing various federal excise taxes on alcohol, cigarettes, gasoline, and some luxury items, starting in 1983. Nor do I think corporations should go untouched. Review of certain of the tax changes affecting corporations that were enacted last year may be appropriate, specifically including the so-called safe harbor leasing provision and some of the tax allowances on hydrocarbon extraction. At the same time, it is vitally important that needed incentives for investment in new plant and equipment be preserved, including especially provisions for adequate capital recovery allowances. The patent inadequacy of these allowances prior to last year, coupled with inflation and excessive regulatory burdens, was a major factor in the effective decapitalization of a great deal of our capital-intensive industry, particularly steel, non-ferrous metals, railroads, the airlines, and utilities.

I am concerned about the potential adverse effects of the proposed minimum corporate tax on investment incentives. For example, according to a recent article by Emil Sunley, Director of Tax Analysis for Deloitte, Haskins and Sells, about half of the revenue gain through imposition of the minimum tax would derive from limitations on just one tax preference, namely the use of the investment tax credit.[1] As Sunley goes on to explain,

> Any minimum tax blunts the incentive effects of tax preferences. Congress, by enacting a minimum tax, in effect is saying that if a business engages only a little in activities encouraged by tax subsidies, ...no minimum tax is imposed. But if the business is good at these activities and specializes in them, it will have to pay the minimum tax, putting it at a competitive disadvantage.

7. Even if the probable yield that can be realized from the kind of revenue measures I have cited should prove to be substantial, I find it hard to envisage that it would, in conjunction with realistically achievable expenditure cuts, be substantial enough to produce the decisive reduction in the potential deficit that is needed. Hence, I believe that we must look for additional revenues through deferral of the provision for indexing personal income taxes beginning in FY 1985 and, possibly, elimination or postponement of at least part of the personal income tax cut now scheduled for 1983. The potential added revenues from either or both of these steps, or possible variants that have been proposed, could, of course, be very large.[2]

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[1] See Tax Notes, February 15, 1982.

[2] Shown below are estimated revenue effects of various alternative possibilities for deferral of the indexation of personal income taxes and of the scheduled reductions in these taxes. (Sources: Congressional Budget Office, Reducing the Federal Deficit: Strategies and Options (February 1982) and, for Item (e), Office of Senator Dole.)

Footnote 2, continued

I would consider postponement of tax indexing ahead of any decision to defer the 1983 personal tax reduction. To reach the overall goal for reducing the deficit, however, it may as a last resort also be necessary to defer or stretch out at least part of the scheduled 1983 tax cut.

Footnote 2/ from p.9 continued:

(a) Full deferral or elimination of the scheduled 10 percent personal income tax cut in 1983 and of the tax indexing now scheduled to start in 1985. According to the Congressional Budget Office, these two steps combined would, on an annual basis, cut the prospective deficit by $9 billion in 1983, $37 billion in 1984, $54 billion in 1985, and $76 billion in 1986. On a cumulative basis, the estimated revenue savings would come to $46 billion in 1984, $100 billion by 1985, and $176 billion by 1986.

(b) Deferring tax indexation but retaining the 1983 tax cut. This would yield estimated annual savings of $12 billion in 1985, $30 billion in 1986 and $51 billion in 1987.

(c) Eliminating or deferring the entire 1983 personal income tax cut but retaining tax indexing. Annual savings: $9 billion in 1983, $37 billion in 1984, $40 billion in 1985 and $44 billion in 1986. Cumulative savings by 1985: $86 billion.

(d) Reducing the 1983 tax cut to 5 percent. This would, by itself, produce annual budget savings of $4 billion in 1983, $18 billion in 1984, $20 billion in 1985 and $22 billion in 1986. Cumulative savings by 1985: $42 billion.

(e) "Stretching out" the scheduled 1983 tax cut, so that a 5 percent cut would be scheduled for July 1, 1983 and another 5 percent cut for July 1984. This would save $4 billion in 1983 and $14 billion in 1984, but only $1 billion a year in 1985-87. Cumulative savings by 1985: $19 billion.

(f) Eliminating the scheduled 1983 tax cut but starting tax indexation in that year instead, as proposed by Senator Dole. Assuming 7 percent inflation in 1983, this would by 1985 produce about three-fourths of the accumulated savings generated by reducing the 1983 tax cut to 5 percent.

(g) Making activation of tax indexation beginning in 1985 contingent on specified improvements in the budget situation.

CED strongly favors a longer-run objective of gradually reducing the total share of GNP taken by taxes, in balance with the phased reduction in government spending as a share of GNP. We have also taken the position, however, that the nation must be prepared to finance any necessary increases in defense spending on a noninflationary basis. In this sense, deferment or stretch out of all or part of the 1983 tax cut and of the subsequent income tax indexation ought to be seen as part of the price that has to be paid for the projected sharp step-up in national security outlays.

If agreement on any package of budgetary trimming is to have its desired effect on the financial markets, business and the public, several conditions must be met. The first of these, to be quite blunt, is that the proposed plan must be fully credible. On too many occasions spanning several Administrations and Congresses, budget numbers promulgated by the Executive Branch as well as the Congress have failed to meet that condition. Yet given the amount of supplemental information now available and the number of analysts with sharp pencils in financial houses, business firms, universities and the press who follow these numbers, it now usually takes only a relatively short time before any lack of credibility becomes apparent to everybody. I very much hope, therefore, that any agreed new program for deficit reduction will from the start be one that is generally accepted as "adding up."

There must also be convincing indications that the proposed reductions will, in fact, be carried out. Congress' recent failure to pass a meaningful budget resolution and current talk of a possible breakdown of the entire budget process are clearly very detrimental in this connection.

I am not one of those who put the blame for all this on the budget process as such. The present procedures represent a major advance over the way things were done prior to the Budget Act of 1974. Without the tools provided by that Act, the various participants in the current budget debate would not be able to discuss detailed budget projections for three or more years ahead, argue about economic assumptions, or come up with prompt estimates of potential budget savings through alternative approaches. Cynics might say this may not be all bad. But the fact is that the new process has given Congress major new tools for making more rational budget decisions. The chief problem lies in facing up to the basic choices now that they are being presented with greater clarity.

I do not think that new legislation is required this year to improve the budget process. But if the business community is to have continuing confidence that agreement on a deficit-reducing package will actually be carried out, it will be highly important that the Congress passes the required legislation expeditiously and adheres to the basic requirements and timetable of the budget procedure. We believe that various other steps should also be taken to make that procedure more effective, such as giving binding force to the first resolution, bringing credit activities under closer control, moving various activities now classified as "off-budget" back into the budget, and subjecting not only the spending side but also the revenue side of the budget to closer scrutiny, particularly where it involves tax provisions that have the same purpose as particular expenditure programs and should be examined jointly with such programs. The most important immediate need, however, is to reach an agreement on an adequate cutback in the budget deficit that will be widely regarded as realistic.

With a credible program for progressively lowering the deficit in coming years, there is a strong chance that interest rates will be significantly reduced. Such a fiscal policy would provide assurance that monetary policy could be directed at fostering rates of monetary and credit expansion adequate to support noninflationary real growth in the economy.

Cutting deficits and improving the fiscal-monetary mix of course constitutes only part of what is needed to restore healthy noninflationary growth and make our economy more productive as well as competitive. Another part of the answer lies in removing inappropriate disincentives to the effective working of the market mechanism and in positive measures to increase productivity. The sharp slowdown in U.S. productivity growth since 1973 has been profoundly disturbing, particularly when one considers that our rate of productivity growth has lagged significantly behind those recorded by many of our major competitors among the industrial countries. CED is currently working on an in-depth study of how productivity might be improved, as well as on a parallel study that examines a desirable industrial strategy to make this country more competitive and allow it to adapt effectively to the emerging needs of the 1980s.

At the same time, we believe there is need for greatly increased focus on the potentials for more extensive public-private cooperation in a variety of areas. Just a few weeks ago, CED issued a new policy statement on the opportunities which public-private partnership poses for urban communities.[1/] That statement examines in detail what has made for successful public-private cooperation in seven major cities -- Atlanta, Baltimore, Chicago, Dallas, Minneapolis-St. Paul, Pittsburgh, and Portland, Oregon -- and points to the elements of these successes that may be transferable to other communities.

Our earlier 1978 statement Jobs for the Hard-to-Employ: New Directions for a Public-Private Partnership similarly pointed to successful instances of public-private cooperation in developing training and job programs for the disadvantaged. While that statement served as a catalyst for increased private sector involvement in these efforts, including the creation of Private Industry Councils, we are by no means satisfied that these efforts are as vigorous or effective as they could be. CED's Program Committee expects shortly to issue a statement which spells out the steps that we believe are needed to achieve more effective and sustained business involvement in this area. Steps to enable smaller businesses to participate effectively in these programs will be an important element of our recommendations since a high proportion of the new entry-level jobs for the disadvantaged opens up in smaller businesses.

[1/] See CED policy statement Public-Private Partnerships: An Opportunity for Urban Communities, February 1982.

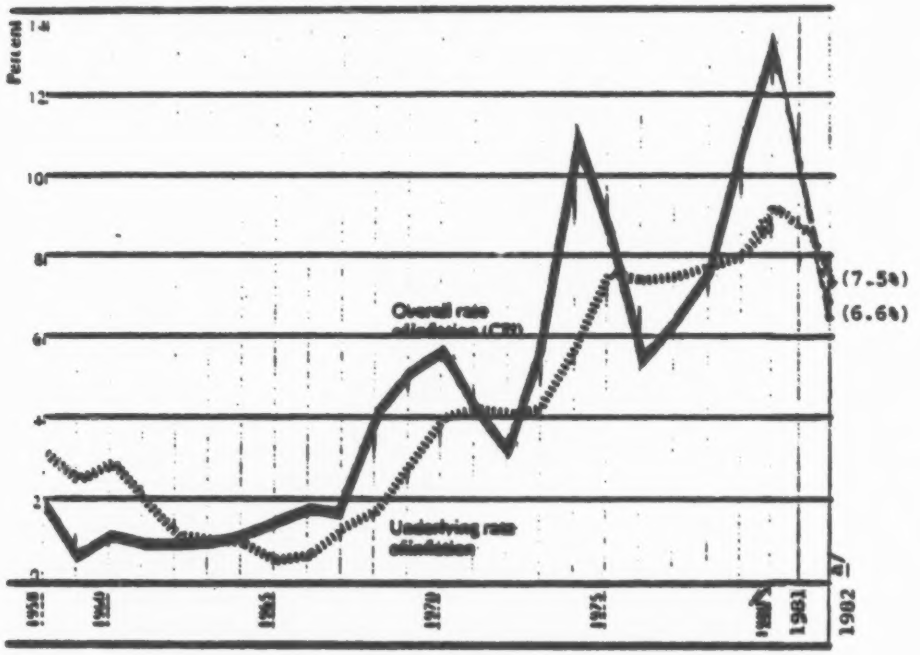
I myself have taken a special interest in another area of needed public-private partnership: namely, ways in which businessmen can help to improve the caliber of our nation's high school graduates. The quality of workers entering the labor force in the next few years will be of major importance for the success of our efforts to revitalize the nation's economy. There is a great deal that business can do, in cooperation with local educational institutions, to assist in developing high school graduates who are not only well-rounded academically but who also have the flexibility and capacity for leadership needed to cope with the challenges of the coming decades.

I want to make it very clear that in emphasizing the potentials for public-private partnership in a variety of fields, we are not suggesting that the private sector can or should be expected to assume full responsibility for meeting needs that will result from current cutbacks in federal domestic programs. What we are saying is that with time and proper preparation, public-private cooperation at the local level can accomplish a great deal more than is generally realized. This can, in time, also help lighten the burden on public sector budgets. We are also saying that success in these efforts does not depend on money alone but requires creative and energetic personal involvement by public and private local leaders to work out mutual problems in a constructive fashion. The President's new Task Force on Private Sector Initiatives which is headed by my good friend, Bill Verity, is working hard on plans for encouraging such involvement.

All of these efforts at public-private cooperation can contribute to a national economic environment that is conducive to steady, non-inflationary growth. But early and convincing action to restore the more viable fiscal-monetary mix needed to achieve that goal should be everyone's first order of priority today.

FIGURE 1

Overall and Underlying Rates of Inflation



Various alternative measures can be used to depict overall and underlying inflation. In this chart, the overall inflation rate is represented by the consumer price index (CPI). Underlying inflation is represented by the "core rate" concept developed by Data Resources, which measures the weighted average of the trend rates of growth in unit labor and capital costs (with weights equal to the estimated shares of these costs in total value added and with adjustments for productivity growth). For a detailed technical description, see Otto Eckstein and Robin Siegel, "More on Core Inflation." *Data Resources U.S. Review* (June 1979), pp.I.19–I.23.

a/ 1982 figures partly estimated by Data Resources.

SOURCES: U.S. Department of Labor, Bureau of Labor Statistics, and Data Resources, Inc.

MARCH 22, 1982
STATEMENT OF DANIEL FENNELL, DIRECTOR
MID-ATLANTIC TRADE ADJUSTMENT ASSISTANCE CENTER
BEFORE COMMITTEE ON THE BUDGET
UNITED STATES SENATE
WASHINGTON, D.C.

Senator Domenici, Senator Hollings, my name is Daniel Fennell and I would like to thank you and the Committee members for the opportunity to enter this testimony on behalf of the Trade Adjustment Assistance Program for firms and industries which is enabled under Chapter 3 of Title II of the Trade Act of 1974. I am the Director of the Mid-Atlantic Trade Adjustment Assistance Center which I will refer to as the TAAC. We are headquartered at One East Penn Square, Philadelphia, Pennsylvania and also have offices in the Investment Building, 239 Fourth Avenue, Pittsburgh, Pennsylvania. Until November of 1981,we had an office at 210 North Charles Street, Baltimore, Maryland. The TAAC is administered by the Council for Labor and Industry, a private, non-profit, regional economic development corporation which was established and is directed by representatives of industry, labor, government and professionals in strategic planning and area development. The Council operated the TAAC in conjunction with Penjerdel, the Pennsylvania, New Jersey, Delaware Chamber of Commerce, with whom we still participate on other joint programs, until April, 1980.

The TAAC enables the Council, and the host organizations of ten other TAAC's situated throughout the country, to work intensively, in a consulting relationship, with a startingly large number of companies whose businesses have been disrupted by the influx of imported products. A January, 1981 study commissioned by the U.S. Department of Commerce has estimated that in the 50 states and District of Columbia there are more than 48,000 firms employing over 4,000,000 people in industry sectors impacted by imports. Our headquarters state of Pennsylvania ranks third in the number of people employed by such firms: 600,000 people are employed there in 3,000 impacted firms. California and New York rank number 1 and 2 in affected firms; Illinois is fourth, with figures very similar to Pennsylvania's. More than 250,000 workers are employed by such firms in ohio, which, like Michigan, New Jersey, Texas, Florida, Connecticut, Wisconsin and Indiana has more than 1,000 affected firms. In fact, every state represented on the Budget Committee has,in proportion to its manufacturing population, significant numbers of firms and employees whose markets have been eroded by imports. Missouri, Minnesota, Rhode Island, Tennessee, Washington, Georgia and North Carolina are each in the "top" twenty in number of firms, with no less than 55,000 workers in any one state: In Tennessee and Missouri, employment in these firms is over 100,000 and in North Carolina it is close to that figure. Employment in firms in Oregon, Colorado, Kansas and Iowa is scarcely less stable. Oklahoma is right in the middle - 27th in number of firms. Senator Hollings's state of South Carolina is close behind with 70,000 people employed in more than 300 firms who are hurt. If I were from Arkansas or Louisiana, I would be interested in the close to 300 firms in each of those states which make them 33rd and 34th on the list. Utah and Nebraska each have more firms than a dozen other states, and Hawaii's 41st place would remind me that the beautiful islands do not only draw tourists but are increasingly attractive as a marketplace for imported goods, as well. Idaho, 40th in number of firms, has twice as many employed in them as Hawaii does; and neither West Virginia, New Mexico, Wyoming, Delaware, Montana, the District of Columbia nor North or South Dakota are immune from the impact of imports.

Although there are only eleven TAAC's, service is provided by them to firms in every state. My own center, for example, provides consultant services and management assistance for firms in 5 states: Pennsylvania, Delaware, Maryland, Virginia, and West Virginia. TAAC services are paid for both by funds from the International Trade Administration and by fees from assisted firms who pay at least 25 percent of chargeable costs. The Rocky Mountain TAAC has been established just this year to work with firms in that region. Although each TAAC is an independent organization and is not a part of the Federal Government, we work cooperatively with the Office of Trade Adjustment Assistance, which is a part of the International Trade Administration in the Department of Commerce. I have attached a list of all the TAAC's, the names of their Directors, their addresses and the regions which they serve. While I am from the Mid-Atlantic TAAC, my remarks relate to all of the TAAC's and each of those Centers has agreed to my statement.

I would like to make it clear that I am not testifying against the Administration, but for the program. My purpose is to enlarge your perception of its activity, to bring into view some of the successes which it has achieved, and to ask your support in continuing it.

I understand that the Administration has proposed to terminate Trade Adjustment Assistance for firms and industries because the loan portfolio is weak and only 65 firms per year have benefitted from loans and loan guarantees. I respectfully submit that neither the program nor its accomplishments is either accurately or properly portrayed by isolating on the lending activity. The number of firms benefitting from loans is a small percentage of the firms with whom TAAC's have worked. Furthermore, about 100 of the loans in the portfolio, nearly one-third of the entire portfolio, were made before TAAC's existed, the number of loans per year has declined steadily since fiscal year 1979 (the amount closed in 1981 is 46 percent of the 1979 figure), the screening of firms and scrutiny of loans has tightened during that period, and, last year, the Congress further strengthened the loan provisions of the Act. It should be remarked, as well, that even with the deliquency rate that has been experienced, the government has not lost money on its loans. In fact, for the whole PWEDA portfolio (of which Trade Act Loans have been a part) there is a net plus balance of approximately $5,000,000. An important development in the financing activity of the program has been its closer linkage with technical assistance. This has meant that loan resources and technical consulting resources are employed in tandem. As a result, business objectives are more attainable, and loans are more secure, closely tied to feasible recovery steps in a strategic turnaround plan.

However, there has been no account of the impressive nature and level of technical consulting help and the hundreds of firms who have not received loan assistance, but who have gained valuable insights and adjustment directions from the consultants provided by or through the TAAC's; nor have the industry association grants, which have gone for strategic examination of 20 key sectors, been described.

According to an independent evaluator of the program, while approximately 75 EDA loans were closed during FY 1980, the second year in which TAAC's operated, over 1100 firms received technical assistance form TAAC's. A substantial number received professional consulting assistance in such areas as production and manufacturing processes, development of incentive programs for workers, strategic marketing and management counseling, installation of control systems and financial forecasting techniques. By far the largest proportion of these firms have not come to the government for loans. As you know, Congress, which established the loan feature of the Trade Act, also established the government as the lender of last resort. In doing so, it accepted the risks associated with such a provision. However, many firms who originally thought that their principal need was a government loan have been shown by the TAAC's that this was not the case. Often, necessary cash flow and working capital has been generated through efficiencies in inventory turns, scheduling and loading, and more effective pricing. Many firms have been able to re-enter commercial financial markets after they strengthened their operations and controls. Besides the loan applications which have come to the Government, we estimate that TAAC's have assisted in obtaining nearly 100 loans from non-Federal sources. I know that even more firms than that have been able to maintain banking and factoring relationships which were threatened before TAAC assistance began. In our TAAC area we believe there have been 51 firms who did not get Federal financing but who were able to regain or maintain other lending relationsips because of the plans they had put into place. In one instance, a $500,000 loan through TAAC helped to leverage a $17,000,000 package from other sources.

Related to the operations of the TAAC's, which work directly with management of individual firms, the Office of Trade Adjustment Assistance has, for 4 years, conducted a program to develop practical remedies for industry-wide problems in critical sectors. To date, there are twenty industries which have benefitted from these examinations and the action strategies which have emerged and are still emerging from them. These industries, each heavily hit by imports, collectively employ over 2,737,000 people, embrace 26,348 firms, and account for $158,445,000,000 a year in shipments and $77,684,000,000 added value. I have included a summary of figures for these nineteen industries as part of this statement. The recipient of the twentieth grant, the Gulf States Fisheries Foundation, represents an industry segment peculiar to its area. Its figures have not been presented with the others.

Mr. Ed Levy, the Executive Director of the National Handbag Manufacturers Association has testified about the positive effect this program has had on the handbag industry. In Philadelphia, a footwear center has been established which is so well-regarded by shoe manufacturers that it has merged with the National Association in that industry and is now being supported almost 100 percent by the industry itself with little need for further Government help. Through the industry program, the apparel industry, still the second largest manufacturing employer in Pennsylvania and a key employer in the North, Southeast, Midwest and

West has developed techniques for improved productivity and technological innovation. The mushroom industry, important in Congressman Schultz's district, is an illustration of a sector in which as imports have increased by 21 percent, employment has decreased by 22 percent.

These efforts are not palliatives for declining constituencies but serious, hard-nosed approaches to regaining competitive positions. The industry program and the program for firms complement one another. Together, they have reached a significant number of firms in labor intensive industries which, cumulatively, are large employers and can be tough competitors.

We are well aware of the distinctions between this Trade Adjustment Assistance Program, which is operated by the Department of Commerce, and the Trade Adjustment Assistance program for workers which is operated by the Department of Labor. The President distinguished between them in his Economic Recovery Program last year. It should be noted however, that assistance for firms and industries benefits workers, too. The real difference is that the program for firms helps workers to keep their jobs, the other program helps those who have lost their jobs.

Successes with firms do not only preserve existing employment in a company, but sometimes increase it as well. This is the reason that the Philadelphia Central Council of the AFL-CIO has recently sent a letter to all of its participating unions urging them to bring the program for firms to the attention of companies with whom they have collective bargaining agreements.

We are pleased to be involved in a program that does so much for businesses and workers with the attendant benefits to the community. We see the results everyday. One firm with whom we worked was on the verge of closing its doors, letting 150 workers go. Our consultants diagnosed operating inefficiencies, installed a new costing system, laid out the plant more efficiently, created an incentive system for workers, and developed comprehensive marketing and management information programs, tailored to operations. This firm subsequently applied for loan assistance, but not until its house was in order. Although it has not closed yet on this loan, already 150 jobs have been saved, operating margins have increased from 2 percent to 10 percent, with a prospect of doubling that, employment has increased by 25 percent and is likely to expand by another 50 percent beyond that. Another one of the firms we are working with tripled sales while TAAC was diagnosing its problems and establishing remedies. There was no loan, just a re-examination of markets and operations. The firm, Gaines

Manufacturing, in Gaines, Pennsylvania, attributes its expansion exclusively to the work of TAAC. These are not isolated examples. The March 1982 issue of Inc. Magazine reported under the heading "Smart TAACtics" on assistance to Gillette Industries, a Wisconsin manufacturer of down outerwear. Three years ago the firm was facing fierce competition from Chinese imports. "With our production costs at $5 an hour, compared to 25¢ an hour for goods produced in China, it's easy to guess who was going to win," said company president Terry Gillette. With assistance from the Midwest Trade Adjustment Assistance Center, Gillette Industries was able to research its options and now produces a line of designer fashions not threatened by overseas competition.

I have included with my statement 37 additional illustrations of the kind of operational improvements which TAAC's have catalyzed. I would like to have them incorporated by reference in my testimony. These few, short case histories from each TAAC area will give you an indication of what is being done for the many more employers and employees for whom we work.

I do not think that anyone seriously related to the program would suggest that it has all been a rosy picture. Mistakes have been made. It has not always been easy to move from idea to actuality or from prescription to practice. However, when mistakes have been made, they have led to correction. I would venture that this is one of the few Federal programs of this size and complexity that has conducted serious, independent evaluations for the primary purpose of identifying successful approaches and effecting improvements within the program.

The move to the International Trade Administration, for instance, was accompanied by important improvements. Coordination of technical assistance is now centered in Washington rather than diffused through six regional offices. I am not an unflinching advocate of centralization, except when it represents efficient streamlining, concentrated effort and consistent application of policy. That is the case here. In the regions, trade assistance was one among many responsibilities of regional offices. It often got less attention than was needed from them. There were sometimes long delays, differing guidance, inconsistent direction. Now we get quick answers - even if we do not always agree with the answers. The Office of Trade Adjustment Assistance has sought the insights of TAAC's in re-fashioning the program, and has acted on these insights. There is greater compatability of view and a much closer working relationship than there was before.

Together, we have refined an adjustment plan procedure which has been remarkably effective in focussing on a logical turn-around for firms. Through the TAAC's, a firm does not file for financial assistance unless a diagnostic survey has examined its strengths and weaknesses and a plan which builds on the strengths and redresses these weaknesses has been crafted. Financial assistance must support realistic stages in a feasible plan. If loans or guarantees are approved, continuing assistance from a TAAC is a covenant in the agreement. To keep a loan, firms must meet the milestones and indicators which are part of every plan. I have already given an example of a firm for whom financial assistance was not possible until after internal readjustments were achieved first.

Within the past year, the Office of Trade Adjustment Assistance has given us more useful guidelines and procedures for developing assistance plans, carrying out the program, and counselling firms. The firms themselves have more confidence in us and more confidence that the Government knows what it is doing. Based upon responses from approximately 70 client firms selected at random from all the TAAC areas by an independent evaluator, we may conclude that:

- TAAC assistance has been responsive to the most important needs of firms,
- A majority of the firms contacted are making substantial progress towards a business turnaround,
- The vast majority of the clients contacted stated that the quality of technical assistance rendered by the TAAC's and/or their consultants has been excellent and has had a positive impact on the operation of the firm.

Besides those 70 firms, I am providing the names and addresses of approximately 350 client firms from all parts of the country who in the last several weeks have expressed their concern for the program.

Mr. Chairman and Members of the Committee, the Trade Adjustment Assistance Program for firms and industries which you have created is unique in this country, and perhaps among other developed nations too, in stimulating a positive adjustment to the impacts of international trade. It can be one of the most effective such programs ever legislated. Nationwide, a team of experts has been assembled. A body of knowledge has been created. Firms have been strengthened. We are at the cutting edge of genuine techniques for responding to firms in periods of economic decline, techniques which, on the micro-level, are only now being studied in serious academic centers.

We support the President's desire to have America producing, competing, fueling its own growth with investment and creativity. We support and are committed to a strong and healthy industrial base in our country. We are concerned that this base is weakening and, in too many cases, eroding. We are experienced in positive adjustment strategies and we know that if improvement is boldly sought, many firms which are not competitive now can become so. Some have not only learned to compete with imports in this country, but have become exporters as well.

On the basis of its record, we think the program should continue. But it will go out of business if the Administration's zero budget proposal eliminates the Trade Adjustment Assistance program for firms and industries in fiscal year 1983. We know that over 80 percent of the jobs in this country are created by small businesses. If this program does not continue, many of these firms will not receive the positive adjustment help they have demonstrated they desperately need and can use to good advantage. This adjustment assistance is not available now and will not be available later from any other source than the Trade Act of 1974.

Let me emphasize that Chapter 3 of Title II of the Trade Act, which provides adjustment assistance for firms and industries, is authorized to be in force until September 30, 1983. The Congress has decided that firms and industries that have been harmed by imports shall be entitled to apply for financial and technical assistance to carry out plans for their adjustment. The proposed budget would deny this assistance at the very time that imports are up, economic indicators are down and alternatives are fading.

The elimination of the program for firms is said to be consistent with the Government's move away from subsidy programs and toward a comprehensive economic plan to address "the real problems associated with deteriorating economic performance."

In our judgement the trade adjustment assistance for firms is not a subsidy program, nor is it exclusively, or even primarily, a government loan program. There is probably no more pragmatic effort, in or out of the Government, which addresses so directly "the real problems associated with deteriorating economic performance." Last year, the program was not only recognized as consistent with the President's Economic Recovery Program, it was the single program removed from the Economic Development Administration (EDA) and placed in the International Trade Administration (ITA) in order to preserve it. One of the staff of the President's Special Trade Representative (who is no longer with that office) remarked to me last year that the program was unique in the kind of work it did for firms and, perhaps more importantly, the kind of work it stimulated firms to do for themselves. The staff member had reached this judgement after visits to firms who had participated in the program. I can understand that if this were a "give-away" program with merely short term or ameliorative purposes, it would be antithetical to the thinking of the Administration. In fact, however, the capacity-building which firms have achieved accords with the President's own approach to economic recovery. When President Reagan recently addressed the World Affairs Council in Philadelphia, he used the analogical distinction between teaching a man to fish as opposed to giving a man a fish to describe his view of the Government's role in the economy. He stressed that it was far better to "teach a man to fish", so he could be self-sustaining than to create a system within which he would remain dependent.

This program teaches a firm to fish. It is not a give away scheme, nor an entitlement program, nor an artificial support system; and we, its advocates, are hard-minded businesspeople, consultants, and practioners. With others, we believe that the program can increase the productive efficiency and competitive position of American manufacturing firms, develop the technical capacity of American producers, and generate new products and markets for these American goods. Overall, the program contributes to the expansion of an efficient industrial base directly serving American Trade Policy.

It would be indeed tragic to terminate the program at this point. We ask that you restore the program for fiscal 1983. The authorization which you recommended for fiscal 1982 has already been cut by 44 percent during the year: The $50 million approved by the House last spring was reduced to $44 million through House-Senate Conference in the fall. The main part of that cut came from technical assistance. The amount was further reduced, after the President's veto, to $34 million. Those cuts affected both technical assistance and loan authority. I now understand that the Administration is reprogramming the fiscal 1982 budget to $28 million. We believe there can be a program for $30 million, although it is more limiting than at $50 million not only in loan dollars, but also in levels of specialist consultant activity.

You have created a program that is effective. We believe that for the number of firms and workers involved, the results achieved and the work still to be done that this is not an expensive proposition. The program is needed. Do not abandon it at a time when it is realizing the very goals of the President's Economic Recovery Program.

TRADE ADJUSTMENT ASSISTANCE CENTERS

Mid-America TAAC
Brenda Perciful, Director
University of Arkansas
Industrial Research and Extension Center
P.O. Box 3017
Little Rock, AR 72203
(501) 371-1971

Area Covered: Arkansas, Kansas, Louisiana, Missouri, Oklahoma, and Texas

Mid-Atlantic TAAC
Daniel Fennell, Director
Suite 1400
One East Penn Square
Philadelphia, PA 19107
(215) 568-7740

Area Covered: Delaware, Maryland, Pennsylvania, Virginia, and West Virginia

Mid-West TAAC
Hiraim Whitcomb, Director
ILT Research Institute
Ten West 35th Street
Chicago, IL 60616
(312) 567-4774

Area Covered: Illinois, Indiana, Michigan, Minnesota, Ohio and Wisconsin, Iowa

New England TAAC
Blanche Greenhill, Director
Suite 620, Statler Office Building
20 Providence Street
Boston, MA 02116
(617) 542-2395

Area Covered: Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont

New Jersey TAAC
John Walsh, Director
CN 990
200 S. Warren Street
Trenton, NJ 08625
(609) 292-0360

Area Covered: New Jersey

TRADE ADJUSTMENT ASSISTANCE CENTERS
(Continued)

New York Metro TAAC
Paul Radow, Director
17 John Street
Suite 500
New York, NY 10038
(212) 964-1213

Area Covered: New York City, Long Island, and Puerto Rico

New York State TAAC
William Williams, Director
4600 Old Vestal Road
Binghampton, NY 13903
(607) 729-2201

Area Covered: New York State (except New York City and Long Island)

Northwest TAAC
Bill Lotto, Director
1218 Third Avenue
Room 618
Seattle, WA 98101
(206) 622-2730

Area Covered: Alaska, Idaho, Montana, Oregon, and Washington

Rocky Mountain TAAC
Bill Scott, Director
3505 Austin Bluff Parkway
Suite 310
Colorado Spring, CO 80907
(303) 594-9449

Area Covered: Colorado, Nebraska, New Mexico, and Wyoming,
North Dakota and South Dakota

Southeast TAAC
Hardy Taylor, Director
Georgia Tech Research Institute
Engineer Experiment Station
Georgia Institute of Technology
Atlanta, GA 30332
(404) 894-3858

Area Covered: Alabama, Florida, Georgia, Kentucky, Mississippi,
North Carolina, South Carolina, and Tennessee

TRADE ADJUSTMENT ASSISTANCE CENTERS
(Continued)

Western TAAC
Radford King, Director
University of Southern California
Denney Research Building
University Park
Los Angeles, CA 90007
(213) 741-8427

Area Covered: American Samoa, Arizona, California, Guam, Hawaii, Nevada, and Utah

Firms Eligible to Apply for
TRADE ADJUSTMENT ASSISTANCE
Which have not yet received Financial Assistance
By State, By Industry
January 31, 1982

Alabama

apparel	4
metal parts	3
	7

Arkansas

apparel	1
bicycle horns	1
	2

Arizona

air pumps	1
apparel	1
electronics, consumer	1
	3

California

apparel	11
apparel trimmings	1
arc lamps	1
auto stampings	1
belts	1
bicycle carriers	1
boats	1
cabinet catches	1
ceramicware	1
computer equipment	1
electronic components	3
electronics, consumer	10
fabric	1
furniture	1
glass blanks	1
gloves (work)	1
handbags	1
jewelry	1
learning materials	1
machinery	1
metal castings	1
microcomputers	1
office machines	1
personal leather goods	1
roller skate bearings	1
skate boards	1
tape (recording)	2
t.v. cameras	1
wall paneling	1
	51

Colorado

apparel	1
flowers	1
luggage	1
	3

Connecticut

apparel	1
electric shavers	1
fishing tackle	1
footwear	1
mechanical paint strippers	1
telephone sets	1
	6

Delaware

food	1

Florida

apparel	4
boats	1
fabric	1
footwear	1
handbags	1
quartz crystals	1
	9

Georgia

apparel	3
machinery	1
(sports) ball carcasses	1
stoves	1
towels (industrial)	1
	7

Idaho

cedar shakes	1
stoves	1
	2

Illinois

apparel	1
amusement rides	1
CB antennas	1
curtains	1
electronics, consumer	3
electronic counters	1
fasteners, industrial	1
fishing tackle	1
food	1
handles (purse)	1
key-chain holders	1
machinery	2
musical instrument pts.	1
office copiers	1
optical prisms	1
x-ray equipment	1
	19

Indiana	
apparel	4
belts	1
belt buckles	1
electronic components	1
electronics, consumer	3
fasteners, industrial	1
flowers	1
handbags	1
leather	1
machinery	2
metal parts	2
radio testing equipment	1
steel tubing	1
stoves	1
table legs	1
tires	1
wood heaters	1
	24

Iowa	
apparel	1
food	1
plastic parts	1
	3

Kansas	
fishing rods	1

Kentucky	
apparel	1

Louisiana	
apparel	1

Maine	
bedspreads	1
footwear	1
footwear components	1
limestone	1
snowshoes	1
wood household accessories	1
	6

Maryland	
apparel	3
drapes	1
electronic components	1
lithographic plates	1
luggage	1
machinery	1
umbrellas	1
	9

Massachusetts	
apparel	10
electrical appliances	1
electronic components	1
eyeglass frames	3
fabric	5
fasteners, industrial	1
fire trucks	1
flower pots (plastic)	1
footwear	3
footwear parts	3
handbags	2
holloware	1
leather	2
machinery	2
meat	1
paint brushes	1
stoves	1
t.v. antennas	1
tools (hand)	1
toys	1
	42

Michigan	
apparel	2
auto parts	2
industrial vises	1
metal parts	1
motorcycle accessories	1
wine	2
	9

Minnesota	
apparel	1
amusement rides	1
CB antennas	1
corn cribbing	1
toys	1
	5

Mississippi	
auto wire harnesses	1

Missouri	
apparel	2
personal leather goods	1
toys	2
	5

Montana	
lumber	2

Nebraska	
quartz crystals	1

Nevada

stoves	1

New Hampshire

apparel	3
electronic components	1
electronics, consumer	1
food	1
footwear	2
footwear components	1
ind. instrumnttn. meters	1
luggage	1
machinery	1
metal parts	1
stoves	1
	14

New Jersey

apparel	20
auto parts	2
brassware	1
ceramic machine parts	1
electrical equipment	1
electronic components	1
electronics, consumer	4
eyeglass frames	1
embroideries	1
fabric	7
flashlights	1
food	1
footwear	1
household accessories	1
jewelry	1
lamp bases	1
metal casters	1
pigment dispersions	1
plastics	1
rabbit skins	1
soap dispensers	1
sodium glucoheptonate	1
screwdrivers	1
steel products	2
	54

New York

apparel	59
auto accessories	1
ball bearings	1
books	1
buttons	2
candles	1
color separations	1
computer equipment	1
credit card imprinters	1
elastic fasteners	1
electronic components	1
electronics, consumer	3
electronic thermometers	1
eyeglass parts	2
fabric	3
fiberboard	1
fishing rods	1
food	1
footwear	3
footwear ornaments	1
fuel tanks	1
gloves	4
handbags	2
handbag frames	1
hangers (clothes)	1
heat transfer equipment	1
instrument cases	1
jewelry	5
lamps, medical	1
machinery	1
meat	4
metal parts	2
mineral water	1
photographic products	2
ping pong paddles	1
plants	2
plastic handles	1
solvents	1
toys	1
water valve curb boxes	1
wine	2
wood handles	1
wood household access.	1
	124

North Carolina	
apparel	5
artificial flowers	1
baskets	1
fabric	2
flowers	1
heating elements	1
metal parts	1
wood accessories	1
	13

Ohio	
apparel	2
ceramicware	1
electronics, consumer	2
fasteners, industrial	2
footwear	1
machinery	1
metal parts	1
plants	2
t.v. antennas	1
	13

Oklahoma	
hunting accessories	1

Oregon	
apparel	1
fireplace screens	1
lumber	2
shakes	3
	7

Pennsylvania	
animal traps	1
apparel	31
auto parts	2
batteries, storage	1
carpeting	1
electronic digital displays	1
eletronic heating elements	1
electronic components	1
fabric	3
fireplace accessories	1
food	7
furniture	1
glassware	1
gloves	1
jewelry	1
meat	2
mining equipment	1
plants	2
plastic molds	1
radio equipment	1
sanders	1
spring steel	1
steel tubing	1
stoves	1
toners for copying mach.	1
valves	1
watch faces	1
wire	1
	69

Puerto Rico	
apparel	2
food	1
furniture	2
table tops	1
tapes (recording)	1
	7

Rhode Island	
apparel	1
jewelry	3
metal products	1
	5

South Carolina	
apparel	1
amusement rides	1
fabric	1
	3

Tennessee	
apparel	1
auto parts	2
gloves	1
handbags	1
wood turnings	1
	6

Texas	
apparel	3
electronics, consumer	2
fuel tanks	1
handbags	2
quartz crystals	2
	10

Utah	
apparel	1

Virginia	
apparel	2
food	1
	3

Vermont	
electronic components	1
electronics, consumer	1
footwear components	1
	3
Washington	
apparel	2
boats	1
crystal housewares	1
flowers	1
food	8
lumber	1
shakes	33
toys	1
	48
West Virginia	
ceramics	1
glassware (gift)	3
	4
Wisconsin	
apparel	3
chemicals	1
fasteners, industrial	1
fishing rods	1
footwear	1
machinery	1
metal parts	1
tractors (garden)	1
	10
Total, all states	616

Source: Office of Trade Adjustment Assistance, International Trade Administration, U.S. Department of Commerce.

(D-3937t)

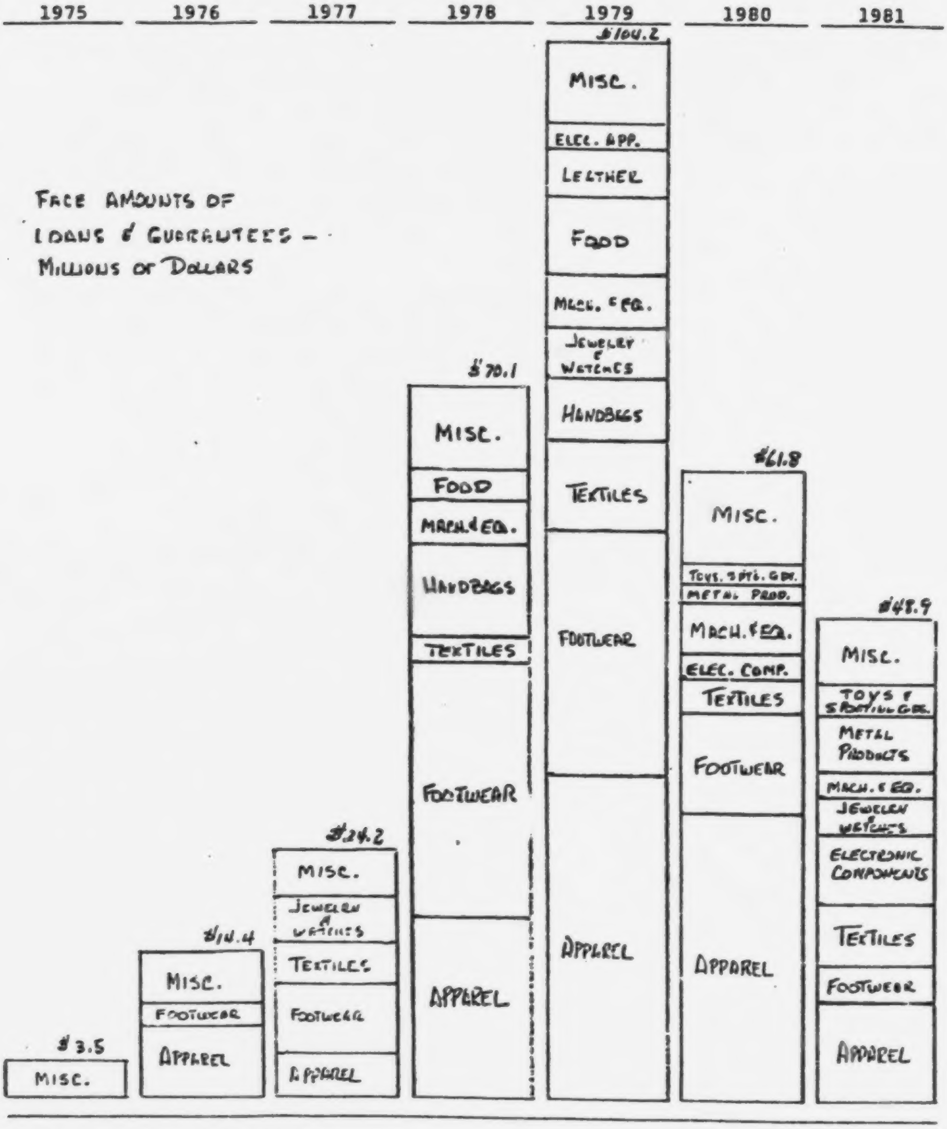
Firms Certified Eligible to Apply for Trade Adjustment Assistance by Industry

	Calendar Year							
	1975	1976	1977	1978	1979	1980	1981	Total
Apparel & Accessories	2	5	28	47	150	146	71	449
Footwear	9	8	49	31	13	17	3	130
Electronics	-	-	2	3	9	10	11	35
Handbags & Parts	-	3	16	10	20	8	9	66
Wood Products	-	-	-	-	4	35	15	54
Communication Equipment	2	-	2	4	15	25	20	68
Metal Products	-	-	1	7	13	14	17	52
Machinery & Equipment	-	-	-	1	10	17	13	41
Food	4	2	1	3	10	25	11	56
Textiles	1	1	2	11	12	20	13	60
Transportation Equipment	-	-	-	-	6	15	9	30
Giftware	-	1	2	1	3	16	5	28
Jewelry	-	1	2	1	8	12	2	26
Fasteners	-	-	-	1	1	7	6	15
Sporting Goods	-	1	-	1	11	6	5	24
Leather	-	-	-	1	3	5	-	9
Furniture	-	-	1	-	1	8	2	12
Flowers & Plants	-	-	-	1	5	5	6	17
Miscellaneous	4	8	4	6	35	55	37	149
Total	22	30	110	129	329	446	255	1,321

Source: Office of Trade Adjustment Assistance, International Trade Administration, U.S. Department of Commerce

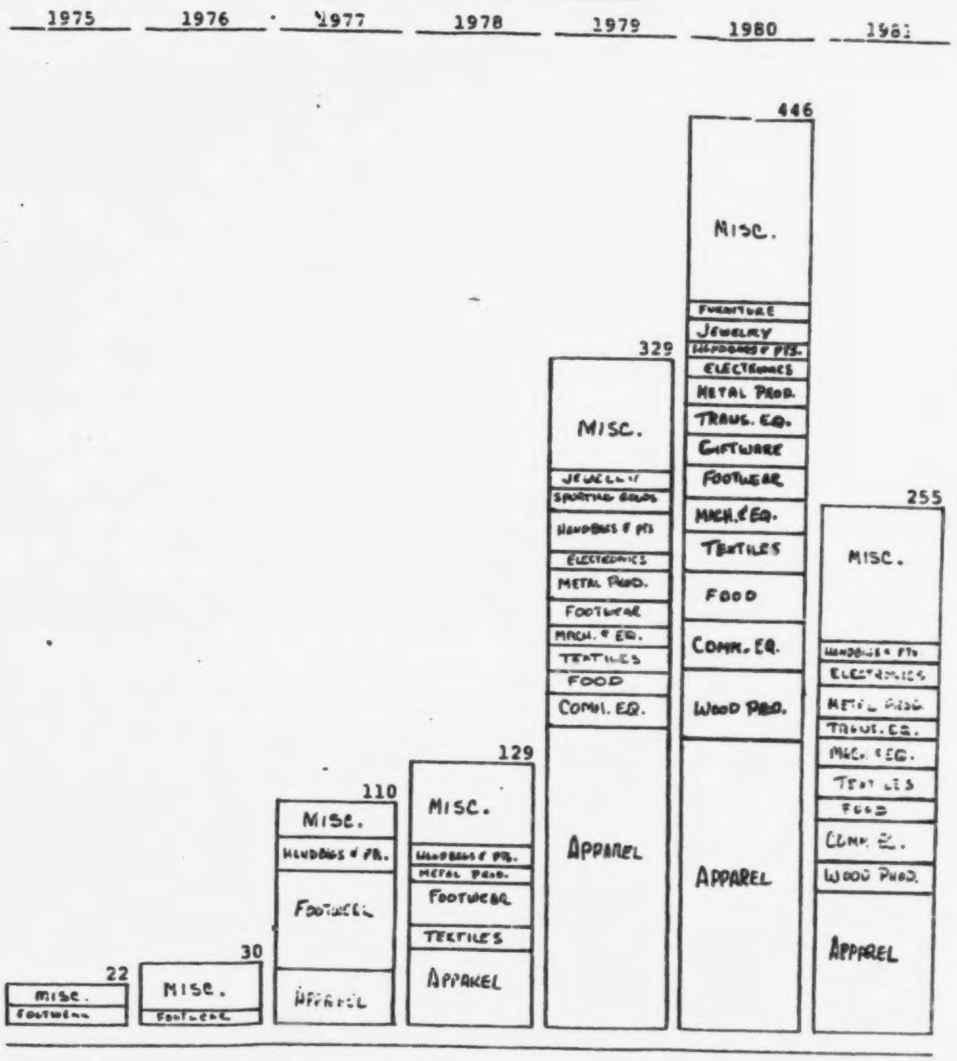
(D-3941t)

FINANCIAL ASSISTANCE AUTHORIZED FOR CERTIFIED FIRMS
Under the Trade Act of 1974
By Major Industry



CD/OTAA 02/19/82 D-3943t

MAJOR INDUSTRIES REPRESENTED BY FIRMS CERTIFIED ELIGIBLE TO APPLY FOR TRADE ADJUSTMENT ASSISTANCE



CD/OTAA 02/01/82 D-9736B

Number of Firms Certified Eligible to Apply For Trade Adjustment Assistance Calendar Year 1981

Industry	No. of Firms Certified	Investigation Terminated or Petition Withdrawn	Petition Denied	Certification Pending 12/31/81	Total Petitions Accepted for Filing
Apparel	62	8	--	7	77
Apparel accessories, belts, billfolds, gloves, hats, scarves, zippers	9	3	--	1	13
Art objects, giftware, glassware, ceramicware	5	1	--	1	7
Beverages, wine	2	--	--	--	2
Bristles	--	1	--	--	1
Coal & coke	--	1	--	--	1
Communication & sound equipment (antennas, loudspeakers)	20	3	--	1	24
Electrical appliances, lighting	2	--	--	--	2
Electronic components	11	4	--	--	15
Fishing tackle	3	1	--	--	4
Flowers & plants	6	--	--	--	6
Foods (except mushrooms)	10	2	--	1	13
Footwear	3	2	--	1	6
Furniture & parts	2	--	--	1	3
Handbags	7	--	--	--	7
Handbag parts	2	--	--	--	2
Heating equipment	8	--	--	--	8
Industrial fasteners, hardware	6	1	--	--	7
Jewelry	2	--	--	--	2
Leather, skins	--	2	--	--	2
Luggage	4	--	--	--	4
Machinery & equipment	13	2	--	3	18
Metals: bars, wire, pipe, sheet, strip, rod, fabricated steel	5	4	--	--	9
Metal castings, forgings, stampings, molds	12	2	1	1	16
Miscellaneous**	7	--	--	--	7
Mushrooms	1	1	--	--	2
Optics: eyeglass frames, molds, parts, lenses	3	1	--	--	4
Plastic products: molded, laminated, sheet	5	--	--	--	5
Sporting goods (except fishing tackle	2	1	--	1	4
Stone products	--	1	--	--	1
Textiles	13	2	--	1	16
Tools	2	--	--	--	2
Toys	4	1	--	1	6
Transportation equipment & accessories (including boats)	9	5	--	--	14
Wood shakes & shingles	7	1	--	1	9
Wood & panel products (except shingles)	8	3	--	--	11
TOTAL	255	53	1	21	330*

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*Includes 54 firms whose petitions were accepted in 1980 for determinations in 1981.

**Includes one certified firm in each of the following industries: (1) amusement rides; (2) animal traps; (3) bearings; (4) footwear components; (5) musical instruments; (6) soap dispensers; and (7) watch faces.

Source: Office of Trade Adjustment Assistance, International Trade Administration, U.S. Department of Commerce

Firms Eligible to Apply for
Trade Adjustment Assistance
which have not yet received Financial Assistance
by Industry, January 31, 1982

	Number of Firms
Apparel & accessories	206
Wood products	46
Food & beverages	35
Electronic equipment	34
Machinery & equipment	32
Textiles	28
Metal products	25
Toys & sporting goods	24
Housewares	21
Footwear & components	21
Transportation equipment	20
Electronic components	16
Handbags & parts	13
Jewelry & watch parts	13
Hardware	11
Flowers & plants	10
Communication equipment	9
Chemicals & plastics	9
Heaters & stoves	8
Optical goods	8
Electric appliances & lighting	7
Furniture & parts	6
Leather & skins	4
Luggage & carrying cases	4
Printing & publishing	4
Musical instruments	1
Stone products	1
Total	616

Source: Office of Trade Adjustment Assistance, International Trade Administration, U.S. Department of Commerce.

(D-3945t)

MID-ATLANTIC TAAC

LIST OF FIRMS

Pennsylvania

Microsonic Trading Corporation
529 Spring Garden Street
Philadelphia, PA

Atwater, Inc.
625 Main Street
Plymouth, PA

Belmont Manufacturing
211 North 13th Street
Philadelphia, PA

Delaware Alloy Forge
2300 Tioga Avenue
Philadelphia, PA

Oxford Corporation
135 North Fifth Street
Oxford, PA

Wallace Leisure Products
31st and Jefferson Streets
Philadelphia, PA

Oxford Royal
Route 79 C
Kelton, PA

A. E. Nelson
34 Baltimore Avenue
Wilkes Barre, PA

Wyoming Valley
237 Old River Road
Wilkes Barre, PA

Print Fashions, Inc.
Ninth and Linden Streets
Bethlehem, PA

Family Garment Company
324 East Locust Street
Scranton, PA 18505

Nachman Industries
(D/B/A Flash Trimming Co.)
801 Arch Street
Philadelphia, PA

London Knitting Company
3799 Jasper Street
Philadelphia, PA

Wexler Knitting Mills
1309 Noble Street
Philadelphia, PA

Lasco Sportswear Company
422 Park Avenue
Williamsport, PA

Cawley Stove Company
27 North Washington Street
Boyertown, PA

Charter Apparel, Ltd.
361 Gordon Street
Allentown, PA

Vinnie Blouse Company
Rt. 512, Box 265
Wind Gap, PA

Gaines Company
Box 35
Long Run Road
Gaines, PA

TACTEC Systems, Inc.
Meadow Lands, PA

Willits Shoe Company
North Second Street
P.O. Box 403
Halifax, PA

Goodimade Manufacturing Company
1010 Race Street
Philadelphia, PA

Atlas Company
17 East Queen Street
Ephrata, PA

Michelfelder's Lunch Meats
5419 North Mascher Street
Philadelphia, PA

Mid-Atlantic TAAC
List of Firms

Watson McDaniel
975 Madison Avenue
Valley Forge Corp. Center
Norristown, Pa

Allentown Manufacturing
315 Linden Street
Allentown, PA

Virginia

Blue Bird Knitting Mills
5200 City Line Avenue
Hampton, VA

Ideal Fishing Tackle Company
20th and Franklin Streets
Richmond, VA

Harwood Company
P.O. Box 1068
Marion, VA

Fass Brothers, Inc.
P.O. Box 3552
Hampton, VA

Imperial Reading
1920 Atherholt Road
Lynchburg, VA

Maryland

Kessler Shoe Manufacturing Company
191 Schaeffer Avenue
Westminster, MD

Hi-Style Industries
4301 Kenshaw Avenue
Baltimore, MD

West Virginia

Crescent Glass Company
Sixth and Yankee Street
Wellsburg, WV

METRO NEW YORK TAAC

LIST OF FIRMS

Salton, Inc.
1260 Zerega Avenue
Bronx, NY 10462
Kitchen Housewares

Musical Instruments Company
of America
170 Eileen Way
Syosset, NY 11791
Musical Instruments

Colorguard Corporation
One Johnson Drive
Raritan, NJ 08869
Vinyl Clad Chain Link Fences

Knit Capers, Inc.
93-37 150th Street
Jamaica, NY 11433
Ladies' Knitwear

Brooklyn Overall Co., Inc.
112 Commercial Street
Freeport, NY 11520
Ladies' & Young Men's Jeans &
Overalls

Tivot Metalwork, Inc.
1000 Alabama Ave.
Brooklyn, NY 11207
Metal Stamping

Multivox
370 Motor Parkway
Hautpauge, NY 11787
Loudspeakers & Musical Instruments

Dependable Knitwear
87-46 123rd Street
Richmond Hill, NY 11418
Children's Knitwear

Dame Belt & Bags
636 11th Avenue
New York, NY 10036
Handbags & Belts

Milt Posner Fur Company
85 Tenth Avenue
New York, NY 10011
Fake Fur Coats

A. Ludwig & Co., Inc.
133 Middleton Street
Brooklyn, NY 11206
Metal Stamping

Bobby Ellen, Inc.
520 Eighth Avenue
New York, NY 10018
Fake Fur Coats

Nelson Brothers
924 Bergen Street
Brooklyn, NY 11238
Metal Stamping

Division Garment Company, Inc.
512 Seventh Avenue
New York, NY 10018
Ladies' Coats, Suits, & Sportswear

Kelly Slax, Inc.
1384 Broadway
New York, NY 10018
Ladies' Pants

Novasac Sales Company, Inc.
416 West 13th Street
New York, NY 10014
Handbags

Corporate Knitting, Inc.
345 Eldert Street
Brooklyn, NY 11227
Ladies' Knitwear

Bowcar Manufacturing Corporation
112 West 34th Street
New York, NY 10001
Children's Wear

North Shore Sportswear
Dickson Street and the Place
Glencove, NY 11542
Ladies' Leather Coats

Braetan Juniors, Inc.
512 Seventh Avenue
New York, NY 10018
Ladies' Coats

Metro NY TAAC
List of Firms

John Karl
209 West 38th Street
New York, NY 10018
Men & Women Sportswear

Claude Clemente, Ltd.
56-02 31st Avenue
Woodside, NY 11377
Jeans

Paddy Lee, Inc.
275 Seventh Avenue
New York, NY 10001
Women's Sportswear

Sue Brett, Inc.
1400 Broadway
New York, NY 10018
Women's Sportswear

Olsen Diesel Engine Corporation
60 South Montgomery Avenue
Bayshore, NY 11706
Diesel Engines

Top Look Leather Fashions
555 Eighth Avenue
New York, NY 10018

Tom Brown Shoe Sales, Inc.
80 Mal Drive
Lindenhurst, NY 11757
Women's Shoes

Felsco, Inc.
116 East 16th Street
New York, NY
Bra Straps

Finesse La Model AB Corporation
Ten East 33rd Street
New York, NY
Handbags

Hercules Plastic Corporation
126-56 Northern Blvd.
Flushing, NY
Plastics

Cable Casting Co., Inc,
270 West 39th Street
New York, NY
Metal Castings

Human Form Hanger and Display, Inc.
6101 16th Avenue
Brooklyn, NY
Displays

Cort Industries Corporation
304 Hudson Street
New York, NY 10013
Slide Fastners

Tarra Hall Clothes, Inc.
Ten West 20 Street
New York, NY 10011
Men's and Ladies' Clothing

Regal & Wade Manufacturing Company
53-23 Nurge Avenue
Maspeth, NY 11378
Photo Albums

Morrisville Company
111 West 40th Street, Suite 2403
New York, NY 10018
Textiles & Knit Fabrics

Carter Leather Goods
330 Fifth Avenue
New York, NY 10003
Small Leather Goods

A & B Sportswear
564 Broadway
New York, NY 10012
Children's Pants & Shorts

Irwill Knitwear Corporation
1407 Broadway
New York, NY 10018
Ladies' Knitwear

Helbros Watches, Inc.
Two Park Avenue
New York, NY 10016
Watches

Abe Levine Knitting Mills
1329 Willoughby Avenue
Brooklyn, NY 11237
Ladies' Knitwear

Hygrade Sportswear Company, Inc.
85 Fifth Avenue
New York, NY 10003
Men's Clothing

Financial Assistance Authorized for Certified Firms Under the Trade Act of 1974

Calendar Years 1975-1981
($000)

								Cumulative Total	
Industry	1975	1976	1977	1978	1979	1980	1981	No. of Firms	Financial Assistance Authorized ($000)
Apparel	--	7,050	3,935	18,281	32,102	29,403	10,115	97	100,886
Footwear	1,000	2,330	6,967	25,479	24,800	10,350	3,700	63	74,626
Textiles	--	--	4,455	2,500	9,296	3,517	6,335	18	26,103
Handbags	--	930	2,512	9,062	6,640	530	600	30	20,274
Machinery & Equipment	1,000	1,000	--	4,620	5,300	4,905	2,550	14	19,375
Jewelry & Watches	--	--	4,600	1,597	5,050	1,000	4,124	11	16,371
Foods & Beverages	--	--	550	3,200	7,500	1,300	1,350	9	13,900
Electronic Components	--	600	--	1,735	--	2,422	6,700	11	11,457
Metal Products	--	--	--	1,000	800	2,000	5,435	9	9,235
Toys & Sporting Goods	--	--	--	250	1,150	2,143	3,450	9	6,993
Leather	--	--	--	--	4,750	--	--	2	4,750
Electric Appliances	--	--	--	--	2,700	1,700	--	3	4,400
Housewares	--	--	275	--	1,460	375	1,395	6	3,505
Marble & Granite	1,500	1,690	--	--	--	--	--	3	3,190
Gloves, Belts & Zippers	--	750	--	1,425	--	384	--	4	2,559
Furniture	--	--	--	--	800	--	1,600	2	2,400
Umbrellas	--	--	--	950	414	--	--	2	1,364
Chemicals	--	--	--	--	--	--	1,000	1	1,000
Musical Instruments	--	--	--	--	--	1,000	--	1	1,000
Stoves & Heaters	--	--	--	--	1,000	--	--	1	1,000
Photo Albums	--	--	500	--	400	--	--	2	900
Wood Products	--	--	--	--	--	--	550	1	550
Eyeglass Frames	--	--	473	--	--	--	--	1	473
Animal Tags	--	--	--	--	--	410	--	1	410
Medical Supplies	--	--	--	--	--	400	--	1	400
TOTAL	3,500	14,350	24,267	70,099	104,162	61,839	48,904	302	327,121

SOURCE: Office of Trade Adjustment Assistance, International Trade Administration, U.S. Department of Commerce.

SUMMARY OF ECONOMIC ACTIVITY
IN INDUSTRIES ASSISTED
BY DEPARTMENT OF COMMERCE INDUSTRY PROGRAM

	Industry	Value of Shipments (Million $)	Value Added (Million $)	Total Employment (000)	Number of Firms	Imports as % of Total Consumption	Compound Annual Rate of Change		Major Producing States
							Value of Imports	Total Employment	
1.	Footwear Non-Rubber	683	406	22	192	50.2	26.0	(1.3)	PA, MI, MA, TN
2.	Luggage	744	364	16	298	28	37.0	(1.2)	New Eng; Mid-Atlantic; CO
3.	Leather Goods	2,017	532	18.5	465	11.5	18.1	(3.8)	MA WI NY NJ PA CA
4.	Steel	39,396	14,059	429	1,193	16.6	10.0	(1.8)	East; North Central
5.	Textile Machinery	1,190	675	26	638	46.9	13.3	(2.2)	Southeast & Northeast
6.	Costume Jewelry	955	550	26.7	847	15.4	45.0	(2.6)	RI NY MA NJ CT CA
7.	Consumer Electroncis	7,847	3,256	84	581	47.0	18.4	4.0	IL CA PA VA
8.	Stainless Steel Flatware	560	305	9.1	258	23.5	19.7	(1.0)	MA CT NY IL
9.	Red Cedar Shakes & Shingles	319	137	6	565	48.0	46.9	(14.0)	OR WA CA
10.	Pipe Fittings	8,125	4,830	114	902	8.6	14.0	2.2	OH IL PA TX
11.	Apparel/Textile	87,379	36,836	1,616	18,064	10.8	26.5	(1.3)	Southeastern; Mid-Atlantic
12.	Paper Machinery	27,300	12,300	203	646	11.4	15.6	.8	GA AL LO WI OR ME
13.	Vitreous China	187	152	7.3	28	50.1	19.0	6.2	PA WV NY NJ OH CA
14.	Earthenware	106	78	4.8	23	62.4	18.2	(5)	PA WV NY NJ OH CA
15.	Work Gloves	377	150.8	14	110	31.5	21.5	(39)	MI MN WI

SUMMARY OF ECONOMIC ACTIVITY
IN INDUSTRIES ASSISTED
BY DEPARTMENT OF COMMERCE INDUSTRY PROGRAM

	Industry	Value of Shipments (Million $)	Value Added (Million $)	Total Employment (000)	Number of Firms	Imports as % of Total Consumption	Compound Annual Rate of Change: Value of Imports	Compound Annual Rate of Change: Total Employment	Major Producing States
16.	Industrial Fasteners	4,200	2,496	68	500	50	15.0	(7)	OH IL PA TX
17.	Handmade Glass	95	54	45.9	325	26.4	25	(29)	OH PA WS SC
18.	Mushrooms Canned/Fresh	358.8	178.7	8	527	40	21	(22)	OH CA MI WA PA (50%)
19.	Handbags	648	324	18	186	41	24.6	(4)	NYC
TOTALS		158,445	77,684	2,737	26,348				

Sources 1977 Census of Manufacturers, Department of the Census; Bureau of Labor Statistics

Metro NY TAAC
List of Firms

Richtone, Ltd.
498 Seventh Avenue
New York, NY 10018
Women's Sportswear

Rhodes Electronics Company
104-25 195th Street
Hollis, NY 11412
Electronics

Valmont, Inc.
171 Madison Avenue
New York, NY 10016

Vance Novelties
12 West 21st Street
New York, NY 10010

W & L Knitting Mills, Inc.
63-49 60th Place
Brooklyn, NY 11227
Knitwear

Trimond Manufacturing Company
224 West 30th Street
New York, NY
Knitwear

Autonumerics, Inc.
120 Plant Avenue
Hautpauge, NY 11787
Lathe Machines

Peerless Sew-Sales, Inc.
262 Mott Street
New York, NY 10012
Sewing Machines

Great Atlantic Shellfish Co., Inc.
50 Emjay Avenue
Brentwood, NY 11707
Fish Processors

Ambico, Inc.
101 Horton Avenue
Lynbrook, NY 11563
Guitar & Camera Straps

William Atkin, Inc.
350 Fifth Avenue
New York, NY 10001
Apparel

Cecile Industry, Inc.
10 Ranick Drive S.
Amityville, NY 11701
Stuffed Toys

Shapiro Wine Co., Ltd.
126 Rivington Street
New York, NY 10002
Wine

Sleepwear, Inc.
One West 34th Street
New York, NY 10001
Pajamas

Lougan Leather Corporation
247 West 38th Street
New York, NY 10018
Leather Goods

R & N Knitted Headwear, Inc.
544 Park Avenue
Brooklyn, NY 11205
Knitwear

Schooner Knitwear Corporation
412 Broadway
New York, NY 10013
Knitwear

Prive Sportswear, Inc.
499 Seventh Avenue
New York, NY 10018
Brassieres

Jameco Metal Products, Inc.
94-34 158th Street
Jamaica, NY 11433
Metal Products

Tiffany Plastics
403 Concord Avenue
Bronx, NY 10454
Novelties & Toys

Trinors Coporation
255 West 36th Street
New York, NY 10018
Apparel

Accurate Casting Company, Inc.
5-20 46th Road
Long Island City, NY
Trophies

Metro NY TAAC
List of Firms

Ay-Won Belt Manufacturing Corporation
41 East 11th Street
New York, NY
Belts

Dawson Industries
1350 Broadway
New York, NY
Lingerie Actionwear

Berger Brothers Leather Goods Co., Inc.
325 Fifth Avenue
New York, NY
Handbags

Accessories By Pearl, Inc.
330 Fifth Avenue
New York, NY
Belts

Carnivale Handbags
540 Park Avenue
Brooklyn, NY
Handbags

Bi-Flex International, Inc.
183 Madison Avenue
New York, NY
Bras & Girdles

Scalies Stitching, Inc.
735 Lorimer Street
Brooklyn, NY
Shoes

Davina Lingerie Corporation
630 Broadway
New York, NY
Lingerie

Indian Footwear
431 Southern Blvd.
Bronx, NY
Shoes

Fox Shoe Company, Inc.
826 Broadway
New York, NY
Shoes

Lewis Purses
350 Fifth Avenue
New York, NY
Handbags

N. Erlanger Blumgart & Co., Inc.
1450 Broadway
New York, NY
Textiles

Pensato, Inc.
47 West 34th Street
New York, NY
Shoes

Char-Len Handbag
732 Howard Avenue
New Haven, CT
Handbags

F & T Jewelry
220 West 19th Street
New York, NY
Jewelry

Cardone & Baker
214 Duffield Street
Brooklyn, NY
Shoes

Alert Shoes Corporation
524 Broadway
New York, NY
Shoes

Flower Handbag Manufacturing Corporation
25 Wall Street
Brooklyn, NY
Handbags

Atlantic Fabricators, Inc.
12 Hinsdale Street
Brooklyn, NY
Shoes

Dippy Knits, Inc.
1650 New Highway
Farmingdale, NY 11735
Knitwear

Herbert Products, Inc.
180 Linden Avenue
P.O. Box 384
Westbury, NY 11590
Driers

Martin Greenfield Clothes, Ltd.
239 Varet Street
Brooklyn, NY 11206
Men's Clothes

Metro NY TAAC
List of Firms

Little World, Inc.
112 West 34th Street
New York, NY 10001
Children's Knitwear

Dunleigh-Tuxton
One East 33rd Street
New York, NY 10016
Men's Neckwear

Jade Handbag
31 West 27th Street
New York, NY 10001
Ladies' Handbags

Bell Handbag
27 West 20th Street
New York, NY 10011
Ladies' Handbags

G & S Handbag Co., Inc.
44 West 28th Street
New York, NY 10001
Ladies' Handbags

The Model Bride, Inc.
318 West 39th Street
New York, NY 10018
Bridal & Religious Accessories

A. P. C. Amplaco Corporation
136 West 21st Street
New York, NY 10011
Handbags

Wade Knitwear, Inc.
652 Grandview Avenue
Ridgewood, NY 11227
Sweaters

Top Form Mills, Inc.
16 East 34th Street
New York, NY Lingerie

Willow Veal Corporation
114 North Sixth Street
Brooklyn, NY
Meat

Best Craft Handbag Corporation
One East 33rd Street
New York, NY
Handbags

Peerless Umbrella Corporation
Six West 32nd Street
New York, NY
Umbrella

Lou Rand Handbag, Inc.
162 Madison Avenue
New York, NY
Handbag

Kadin Brothers, Inc.
Ten West 33rd Street
New York, NY
Handbag

J. T. Koltes Enterprises, Inc.
780 East 135 Street
Bronx, NY
Ladies' Shoes

Joseph Hirsh Sportswear
70 Washington Street
Brooklyn, NY
Men's Outerwear

Honey Bag Company, Inc.
270 Rider Avenue
Bronx, NY
Handbags

Jolie Handbag, Inc.
416 West 13 Street
New York, NY
Handbags

Artsteak Company, Inc.
88 Street & 73rd Avenue
Glendale, NY
Displays

Delizza & Elster, Inc.
840 Fifth Avenue
Brooklyn, NY
Jewelry

Danville Loungewear, Inc.
38 East 32nd Street
New York, NY
Lingerie & Loungwear

Footlight Parade
180 Varick Street
New York, NY
Ladies Shoes

Metro NY TAAC
List of Firms

Steffi Fashions, Inc.
500 Seventh Avenue
New York, NY 10018
Ladies' Clothing

Stoney Brook Fashions
1384 Broadway
New York, NY 10018
Ladies' Sportswear

Mel Jay Leather
247 West 38th Street
New York, NY 10018
Leather Coats

Sunrise Knitwear Company, Inc.
1407 Broadway
New York, NY 10018
Ladies' Knitwear

Brookhaven Textiles, Inc.
1412 Broadway
New York, NY 10018
Textiles

Fancy Industries, Inc.
Ten West 33rd Street
New York, NY
Handbags

Certified Creations, Inc.
Five Varick Street
New York, NY 10013
Slippers

Fox Knapp Manufacturing Company
One West 34th Street
New York, NY 10001
Men's Outerwear

Tensor Corporation
333 Stanley Avenue
Brooklyn, NY 11207
Lamps

Cavalier Clothes
90-09 Van Wyck Expressway
Jamaica, NY 11435
Men's Clothing

Gold Star Hat and Cap Company, Inc.
122 Fifth Avenue
New York, NY 10011
Headwear

COMPANY	SIC
A.T.P. Processors Lts. 1 Van Houten Street Paterson, NJ 07505	2262 Textile Printing
Acme Leather Sptswr.,Inc. 335 South Park Street Elizabeth, NJ 07206	2386 Leather & Cloth Coats
Al Acquaire Shirt Co. 114 Straight St. Paterson, NJ 07501	2321 Men's Shirts
B&B Coat Corp. 51 Madison St. Paterson, NJ 07501	2337 Ladies Coats
Bomar Crystal Co. 201 Blackford Ave. Middlesex, NJ 08846	3679 Quartz Crystals
Brighton-Best Socket Screw Mfg. Co. Green St. Teterboro, NJ 07608	3542 Socket Cap & Square Set Screws
Car-Flite Mfg.Co.Inc. 6 Willow St. Moonachie, NJ 07074	3694 Auto Parts
Chronar Corp. P.O. Box 177 Princeton, NJ 08540	3873 Electronic Components
Cooper Sportswear Manufacturing Co.Inc. 720 Frelinghuysen Ave. Newark, NJ 07114	2329 M/W outerwear
Deer Park Baking Co. South Egg Harbor Rd. Hammonton, NJ 08037	2052 Butter Cookies
Irving J. Dorfman Co. 6612 Broadway West New York, NJ 07093	2397 Schiffli Machine Embroideries
Eastern Laminating 75 Main Ave. Elmwood Park, NJ 07407	2231 Lamination of Textiles
Fabrite Laminating Corp. 70 Passaic St. Wood-Ridge, NJ 07075	2295;2269;3079 Prod.of Laminated Fabrics

COMPANY	SIC
Federal Casters Corp. 785 Harrison Ave. Harrison, NJ 07029	3429 Casters,Wheels & Steel Products
Hardware & Industrial Tool Co. Inc. 2607 River Road Cinnaminson, NJ 08077	3429 Garden Tools, Snow Shovels
Hartford Corp. 99 Jersey Ave., P.O. Box 85 New Brunswick, NJ 08903	30x79 Plastic Films
Janet Knitting Mills 155 Van Wagenen Ave. Jersey City, NJ 07306	2253 Knit Outerwear
Jerome Industries Corp. 136 Market St. Kenilworth, NJ 07033	3612 Battery Chargers & Trans.
Kem Mfg. Co. Inc. River Rd. & Maple Ave. Fair Lawn, NJ 07410	3714 Automobile Parts
John C. Kohaut, Inc. 15 Meeker St. West Orange, NJ 07052	2499 Wood Products
Korelle Industries 36 Mileed Way Avenel, NJ 07001	
Lambertville Ceramic & Mfg. Co. Inc. P.O. Box 128 245 N. Main St. Lambertville, NJ 08530	3269 Ceramic Wear Parts
Melissa & Me, Inc. Bldg.454 Raritan Center Edison, NJ 08817	2643 Polyethylene Film Bags
Meta Frame Corp. 41 Slater Drive Elmwood Park, NJ 07407	3231 Aquarium Supplies
Middletown Leather Co.Inc. 200 Valentine St. P.O. Box 607 Hackettstown, NJ 07840	3111 Leather

COMPANY	SIC
N & R Fashions 13½ Van Houten St. Clifton, NJ 07505	2337 Women's Sportswear
Novel Knit, Inc. 791 Paulison Ave. Clifton, NJ 07011	2253 Knit Outer-wear
Rainbow Dyeing & Finishing Corp. 20-21 Wagarow Rd. Fair Lawn, NJ 07481	2269 Dyeing & Finishing Textile
Ronson Corp. 1 Ronson Rd. Bridgewater, NJ 08807	3634 Cig.Lighters & Appliances
Royal Art Mfg. Corp. 160 Passaic Ave. Kearny, NJ 07032	2599 Furniture & Fixtures
Sally Gee 395 Broad Ave. Ridgefield, NJ 07657	2259 Knitwear
Sobel Brothers, Inc. 400 Barclay St. Perth Amboy, NJ 08862	3961 Costume Jewelry;pearls
Star Coat Mfg.Co.Inc. 251 First St. Hoboken, NJ 07030	2337 Ladies coats, blouses,raincoats
Torsion Balance Co. 125 Ellsworth St. Clifton, NJ 07012	3576 Scales
Triumph Knitting Machine Service,Inc. 18-20 Di Carolis Court Hackensack, NJ 07601	2258 Knitted Fabric
United Speaker Systems, Inc. 101 No. Park St. East Orange, NJ 07017	3651 Produces & Assembles Speakers
Victory Optical Mfg.Co. 1 Victory Plaza Newark, NJ 07102	3851 Eyeglass Frames

COMPANY	SIC
Voltronics Corp. West Street East Hanover, NJ 07936	3675 Precision Piston Trimmer Capacitor
Washington Knitting Mills 50 Harrison St. Hoboken, NJ 07030	2341 Women's under-garments
Wire Cloth Mfgr.,Inc. 133 Kings Road Madison, NJ 07940	3496 Wire Cloth Fabrication
J.O. Wos Knitting Mills 237 Main St. Cliffside Park, NJ 07010	2253 Knit Sweaters & Dresses
York Luggage Corp. 204 North Union St. Lambertville, NJ 08530	3161 Mfg.of Luggage

NEW YORK STATE
TAAC
Trade Adjustment
Assistance Center

Hillside Building
4500 Old Vestal Road
Binghamton, New York 13903
607-729-2201

FIRM NAME AND ADDRESS:	CONTACT PERSON:
Micro-Acoustics, Corp. 8 Westchester Plaza Elmsford, NY 10523	Arnold Schwartz President
Saw Mill River Industries 1051 Saw Mill River Rd. Yonkers, NY 10710	Leonard Weiss President
Self Powered Lighting 8 Westchester Plaza Elmsford, NY 10523	Mitch Nesser
Die Mesh Corp. 121 Stevens Ave. Mt. Vernon, NY 10550	Dominic Borello President
Maguire Bros. Brush Co. 4 Pearl St. Port Chester, NY 10573	Peter Iasillo
Markann Mfg. Co. 69 Warren St. New Rochelle, NY 10802	Seymor Kramer President
K & R Handbags, Inc. 10 North Cherry St. Poughkeepsie, NY 12601	Bernard Rynowecer President

Brotherhood Corp. North St. Washingtonville, NY 10992	Ann Farrell Exec. Vice President
Andmore Sportswear 21 Minisink Ave. Port Jervis, NY 12771	Phil Platania General Manager
Hudson Valley Winery Blue Point Rd. Highland, NY 12528	John Lahey General Manager
FX Systems P.O. Box 1818 Kingston, NY 12401	Ed Nutter President
Barclay Knitwear Edmond Rd. Newtown, Ct. 06471	Samuel Berger Vice President
Draper Egg 30 Elm St. Extension Dryden, NY 13053	Roy Draper President
Becker Electronics Route 145 East Durham, NY 12423	Fred Becker, Jr. President
Kubar Bearings 504 Broadway Troy, NY 12180	Earl Smith Treasurer
Utica Duxbak 815 Noyes St. Utica, NY 13502	Gilbert Jones President
Feuer Leather Gloversville, NY	Bob Ekstein Accountant
J'Mar Glove 66 E. Fulton St. Gloversville, NY 12078	Mark Schwed
Ambroson Glove 95 Arlington Ave. P.O. Box 183 Gloversville, NY 12078	Ralph Ambrosino
Spring Pond Nursery New Boston Rd. Canastota, NY 13032	Dennis Smith

Norwich Shoe Co., Inc. Norwich, NY 13815	Floyd Moon Exec. Vice President
Columbian Rope One Columbian Dr. Auburn, NY 13021	Charles Cherry
Ithaca Gun Co. 123 Lake Street Ithaca, NY 14850	Ed Roelen Vice President - Finance
Clark Greenhouses 6407 Rts. 5 & 20 West Canandiagua, NY 14424	Ken Clark President
Wayne Floral P.O. Box 6 (Welches Rd.) Newark, NY 14513	Heinz Mohr President
Opto Dynetics 100 Fernwood Ave. Rochester, NY 14621	Joseph Schwartz President
M.J. Fitzsimmons Mfg. 418 St. Paul St. Rochester, NY 14605	Jack Soloway President
Rochester Button Co. 300 State St. Rochester, NY 14614	John Spencer Vice President
MXR Innovations 740 Driving Park Ave. Rochester, NY 14613	Phil Betette General Manager
Niacet Corp. Stevens St. Lockport, NY 14094	Ray Mangold Vice President
Upson Co. Stevens St. Lockport, NY 14094	John McIntyre
Recreatives Industries 60 Depot St. Buffalo, NY 14206	Sid Wallach President
Liberty Woodcrafts 3300 Benzing Rd. Orchard Pk, NY 14127	Russell Walsh President

Macler Industries Howard St. Friendship, NY 14739	Paul Macler President
Heritage Cutlery P.O. Box 476 Refinery Rd. Bolivar, NY 14715	Charles Fox President

Total Number of Employees - 9,381

New England Businesses Supporting Trade Adjustment Assistance for Firms

1. **American Pillow**
   Lowell, MA

   65 employees

   Contact: Daniel O'Leary
   President

2. **Atlantic Brands**
   Boston, MA

   12 employees

   Contact: Abrahan Cohen
   President

3. **Bridgeport Silverware**
   Bridgeport, CT

   20 employees

   Contact: Peter Renkert
   Vice President

4. **Bristol Brass Corporation**
   Bristol, CT

   351 employees

   Contact: William Freeborn
   Executive Vice President

5. **Carr Leather Company**
   Lynn, MA

   85 employees

   Contact: Donald Freedson
   Executive Vice President

6. **Cornwall Industries, Inc.**
   South Paris, ME

   230 employees

   Contact: Bo Jernigan
   President

7. **Eastland Woolen Mill, Inc.**
   Corinna, ME

   450 employees

   Contact: Max Striar
   President

8. **L. B. Evans**
   Wakefield, MA

   237 employees

   Contact: Sheldon Jacobson
   President

9. **Fall River Fireplace**
   Fall River, MA

   75 employees

   Contact: John Enos
   Vice President

10. **George Fuller & Son Company**
    Pawtucket, RI

    95 employees

    Contact: Paul Mahoney
    Controller

11. **Grace Shoe Mfg. Co., Inc.**
    Lowell, MA

    330 employees

    Contact: Richard Rosengard
    Treasurer

12. **Haarmann Steel Corporation**
    Chicopee, MA

    85 employees

    Contact: Robert Ryan
    Treasurer

13. Hawthorne Sportswear
Worcester, MA

40 employees

Contact: Edward Salem
President

14. Hayward-Schuster Woolen Mill
East Douglas, MA

425 employees

Contact: Winfield Schuster
President

15. International Navigation Corp.
Woburn, MA

50 employees

Contact: Susan McColmb
Special Project Officer

16. Johnson Steel & Wire Company
Worcester, MA

400 employees

Contact: George Walker
President

17. Knapp King Size Corporation
Brockton, MA

2,200 employees

Contact: Robert Grady
Executive Vice President

18. Laconia Shoe Company, Inc.
Laconia, NH

300 employees

Contact: Robert Selig
Chairman

19. Lockwood Products, Inc.
Leominster, MA

66 employees

Contact: Douglas Detweiler
President

20. Lorraine Handbags, Inc.
Boston, MA

35 employees

Contact: Charles Pagliarulo
Treasurer

21. Lurie Sportswear
Boston, MA

110 employees

Contact: Howard Lurie
President

22. May Optical Company
Wareham, MA

50 employees

Contact: Stuart May
President

23. Mildrum Mfg. Company
East Berlin, CT

30 employees

Contact: Theodore Benson
President

24. Mohawk Industries, Inc.
Adams, MA

45 employees

Contact: John Notsley
Treasurer

25. Northern Heel, Inc.
Dover, NH

115 employees

Contact: Barry Sansoucie
President

26. Pandora Industries, Inc.
Manchester, NH

1,100 employees

Contact: Martin O'Connor
Vice President

27. Parker Metal Corporation
Worcester, MA

350 employees

Contact: Peter Consiglio, Jr.
President

28. Profile Sportswear
W. Lebanon, NH

70 employees

Contact: Frederick Bedford
President

29. F. B. Rogers
Taunton, MA

250 employees

Contact: Edward Levin
Vice President

30. Roosevelt Mills, Inc.
Rockville, CT

100 employees

Contact: Joseph Carter
President

31. Shutzer Enterprises, Inc.
Lawrence, MA

1,200 employees

Contact: Lawrence Shutzer
President

32. Sportsguide, Inc.
Worcester, MA

50 employees

Contact: Fred Aramony
President

33. Sterlingwale Corporation
Fall River, MA

110 employees

Contact: Leonard Ansin
President

34. Sunbury, Inc.
West Warwick, RI

60 employees

Contact: Theodore Feinstein
President

35. Vermont Wood Industries, Inc.
Wilder, VT

65 employees

Contact: James Cossingham
President

36. Vogue Industries
Lowell, MA

15 employees

Contact: George Domaingue
President

37. York Capacitor Corporation
Winooski, VT

110 employees

Contact: Harold Dubilier
President

WESTERN TAAC

CALIFORNIA

California Debs Inc.
2660 S.Hill St.
Los Angeles, California 90007

(213) 232-8191
Walter Gibson-Seymour Fabric
Shoes

Tinkerton Foundreis
P.O. Box 506
Lodi, California 95240

(209) 368-2774
Jim Tinkerton
Cast Iron

Compatible
664 S. Anderson
Los Angeles, California 90023

(213) 268-3123
William Young
Shoes

Caprican Clothing
850 S. Broadway
Los Angeles, California 90014

(213) 627-5565
D'Ette Payne
Women's Clothing

Altech Corporation
1515 S. Manchester
Anaheim, California 92803

(714) 774-2900
Bill Fowler
HiFi Equipment

Admaster Corporation
416 Junipero Serra Drive
San Gabriel, California 91776

(213) 285-1121
Jack Clary
Calculators & Cash Registers

Jack Industries
709 S. Palm Avenue
Alhambra, California 90803

(213) 281-3945
Rene Albrecht
Bungee Cords

CEI
880 Maude Avenue
Mountainview, California 94043

(415) 969-1910
Alan Jensen
Video Broadcast Cameras

Silton Bros. Inc.
3535 S. Broadway
Los Angeles, California 90007

(213) 233-7151
Mr. R. Mc Lean
Apparel

Panama Glove Co. Inc.
1911 4th Avenue
Los Angeles, California 90018

(213) 737-8420
John Duncan
Work Gloves

Henry's Fashions
4232 Whitter Blvd.
Los Angeles, California 90023

(213) 262-4143
Yshemael Garcia
Clothing Subcontractors

J.R.M. Fashions
1200 Santee St.
Los Angeles, California 90015

(213) 749-2379
John McShane
Blouse Manufacturers

Messinger Inc.
15004 Oxnard Street
Van Nuys, California 94111

(213) 997-8495
Elliot Messenger
Jewelry

Sign of the Times
1050 Stanford Avenue
Los Angeles, California 90021

(213) 687-4000
Bernie Corbin
Handbags

Smart Modes
901 S. Broadway
Los Angeles, California 90015

(213) 680-4100
Julius Reines
Womens' Coats

Garry's Leather
2430 S. Hill St.
Los Angeles California 90007

(213) 746-3564
Steve Matzdorf
Personnel Leather Goods

Sonal Manufacturing Company
1200 Santee Street
Los Angeles, California 90015

(213) 747-5572
Allan Rosenwald
Belts & Ties

Montessori
8655 S. Main St.
Los Angeles, California 90003

(213) 971-8223
Marie Yankee
Educational Toys

Ratner Clothes
730 13th Street
San Diego, California 92103

(714) 234-0111
Abe Kassam
Menswear

Pacific Accessory Corp.
3613 W. McArthur Blvd
Santa Ana, California 92704

(714) 957-1434
John Paterson, Sr.
Audio Stereo Components

Varmac Inc.
4201 Redwood Avenue
Los Angeles, California 90066

(213) 821-8071
George Hine
Fishing Pole Hardware

Orofino Fine Jewelry
15301 Ventura Blvd.- Plaza Level
Sherman Oaks, California 91403

(415) 366-4734
Bob McCarty
Ferros Dyecasting

Punch Press Products
1911 E.51st Street
Los Angeles, California 90058

(213) 581-7151
Ron Ryan
Metal Stamping & Forming

Crislu Corporation
141 Nevada St.
El Segundo, California 90245

(213) 322-3444
Lloyd Chrisfield
Jewelry

Auerback & Co.
1200 S. Grand Ave.
Los Angeles, California 90015

(213) 749-0131
Ray Auerbach
Men's Apparel

Sunweld Knitting Company
516 S. Anderson Street
Los Angeles, California 90033

(213) 263-9961
Bill Kay
Metal Fittings

Mica Corporation
10900 W. Washington Blvd.
Culver City, California

(213) 559-4223
Alan Lave
Laminates

McNamara & Peepe Corporation
1607 5th Street
Crescent City
Del Norte, California 95531

(916) 624-2454
Gene Youngreen
Lumber

Threshold
1832 Tribute Rd.-Suite E
Sacramento, California 95815

(916) 927-5061
Nelson Pass
Sound Amplifiers

Florod Corporation
3341 W. El Secundo Blvd.
Hawthorne, California 90250

(213) 679-8201
Rod Waters
Industrial Lasers

Kraft Systems Inc.
450 W. Calfiornia Avenue
P.O. Box 1268
Vista California 92083
(714) 231-1912
Wm. Athing
Controlling and tracking devices

Metlox Manufacturing Co.
1200 Morningside Avenue
Manhattan Beach, California 90266

(213) 545-4516
Kenneth Avery
Ceramic Dinnerware

RTR Industries Inc.
8116 Deering Avenue
Canoga Park, California 91304

(213) 883-0116
Robert Rehorst
Consumer Electronics

Pathcom Inc.
24049 S. Frampton Avenue
Harbor City, Calfiornia 90716

(213) 325-1290
Dell Gaines
Communication Equipment

Pacific Ascente Inc.
1766 N. Helm
Fresno, California 93747

(209) 252-2887
Gene Bricker
Outdoor Down Apparel & Sleeping Bags

Fashion Time Inc.
100 E. Adams Blvd
Los Angeles, California 90005

(213) 749-3475
Kevin Lehman
Contractor for Ladies Sportswear

Hollywood Needle Craft
3777 S. Main Street
Los Angeles, California 90007

(213) 233-4105
William Roen
Childrens Apparel

B&C West
350 Paul Avenue
San Francisco California 94124

(415) 952-8535
Stewart Schneck
Hydroponics

Accent Industries
4920 S. Halladay
Santa California 9705

(714) 979-0531
Ira Mallard
Macrame Hangings

WESTERN TAAC

NEVADA

Schrader Stove Co., of Nevada Inc.
4750 Highway 50 E. #3
Carson City, Nevada 89701

(702) 882-8685
Don Vanhorn
Woodburining Stoves

WESTERN TAAC

ARIZONA

Optisonics
1802 W. Grant Rd.
Tucson, Arizona

(714) 324-4844
Henry Carter
Audio Visual Accessories

604

Case No.	Client Name	Address	Contact & Phone	Product
0005	Atlanta Umbrella	Atlanta, GA	Barney Edelkind 404/981-2400	Umbrellas
0016	Covan Industries	LaGrange, GA	Arthur VanDeventer 404/882-5586	Ball Bladders
0020	Forsyth Industries	Cumming, GA	J. C. Harrington 404/688-3501	Shirts/pants
0021	Dawson Industries	Dawson, GA	Max Angel 212/695-9215	Ladies Sportswear
0027	Donald MacMillan & Sons	Macon, GA	Kenneth MacMillan ← [illegible] 912/745-4725	Tire Recapping Equipment
0042	Wikit, Inc.	LaGrange, GA	L. Duncan Allen 404/882-8101	Wiping Towels
0063	Earth Stove East	Atlanta, GA	Robert Chubb 404/964-0480	Wood Stoves
0066	Kelly Slax	Athens, GA	Stewart Kagel 404/549-6574	Pants
1007	Maple Tree, Inc.	Maplesville, AL	Ray Kliegman 212/354-5190	Blouses

Case No.	Client Name	Address	Contact & Phone No.	Product
1012	Toll Gate Garment	Hamilton, AL	Lem Moore 205/921-3163	Shirts
1033	Southeastern Specialty	Anniston, AL	David Copeland 205/237-6641	Gray Iron Castings
2002	Time Saver Tackle	Opa Locka, FL	Don Bauman 305/685-1323	Fishing Tackle
2003	Pinellas Seafood	St. Petersburg, FL	Tom Cordy 305/743-2271	Processed Seafood
2005	Aly Handbag	Hialeah Gardens, FL	Alberto Llodra 305/822-7411	Handbags
2007	Joy Footwear	Hialeah, FL	Burt Lopez 305/885-9941	Athletic Shoes
2014	Highlands Leather Co.	Sebring FL	J. R. Travers 813/655-1515	Leather Shoe Lining
2019	Steridyne Corporation	Riviera Beach, Fl.	George Poncy, Jr. 305/844-3486	Disposable Thermometer Covers
2023	Injection Footwear	Miami, FL	Alberto Barrocas 305/836-5180	Athletic Shoes

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Case No.	Client Name	Address	Contact & Phone No.	Product
2050	Morgan Yacht	Largo, FL	Adrian Babcock 813/544-6681	Yachts
2051	Beta Handbags	Hialeah, FL	Harvey Judkowitz 305/887-6502	Handbags
2053	Savoy Electronics	Ft. Lauderdale, FL	Robert Young 305/563-1333	Crystals
2057	Miami Footwear	Miami, FL	Joel Robin 305/633-0151	Shoes
3264	Finney Manufacturing Co.	Clinton, KY	Morris Finneburgh, Sr. 216/232-6161	TV Electronics
4020	Harper Industries	Union, MS	Tom Friedland 212/971-9200	Shirts
5001	Crewco, Inc.	Cornelius, NC	Ron Batcho 704/892-1237	Knit Shirts
5008	Keane Monroe	Monroe, NC	Jim Keane 704/2899-5581	Door Openers
5011	Washington Mills	Winston-Salem, NC	Bob Vaughn 919/765-9540	Knit Tops

Case No.	Client Name	Address	Contact & Phone No.	Product
5035	Vaughan's Blue Ridge	Pineola, NC	Debbie Vaughan 704/733-4323	Cut Flowers
5050	Rocky Mount Mills	Rocky Mt., NC	Tom Battle 919/442-1145	Woven Fabric
5090	American Wicker	Boone, NC	Sonja Bennett 704/963-4345	Wicker Furniture
6045	Ehrhardt Manufacturing	Ehrhardt, SC	William Balish 803/267-4125	Women's Dresses
7003	Leather Classics	LaFollett, TN	George Messing 615/562-9461	Leather Apparel
7016	Peden Wood Products	S. Pittsburg, TN	Harold Peden 615/837-6302	Turned Wood
7037	Tennessee Handbags	Dandridge, TN	Frank Hodge 615/397-3112	Handbags
7040	Doyle Shirt	Doyle, TN	Homer Messenger 615/657-2281	Shirts

WESTERN TAAC

HAWAII

Maui Divers of Hawaii Ltd.
1520 Liona Street
Honolulu, Hawaii 96814

(808) 946-7979
Clifford Slater
Jewelry

WESTERN TAAC

UTAH

Jolene Corporation
P.O. Box 1446
Provo, Utah 84601

(801) 373-3206
Don Geiss
Children's Clothing

BOMAR CRYSTAL COMPANY - MIDDLESEX, N.J.

I. BACKGROUND

Bomar Crystal Company was founded in 1963 and incorporated in 1969 as a manufacturer of quartz crystals. The company progressed from a part-time mail order business to a thriving concern reaching a sales volume of $2.9 million in 1976. The next two years reflect a substantial drop in volume attributed to the influx of finished crystal from Japan, Hong Kong, Korea and Taiwan. This period also reflects a substantial drop in the domestic production of C-B radios, also due to imports. As a result, sales dropped more than 50% and substantial losses were recorded for the first time in the company's history. Within a three-year period, production employees dropped from 198 to 49.

Faced with these serious problems, the firm became interested in Trade Adjustment Assistance after first hearing about the program from his banker. The New Jersey Trade Adjustment Assistance Center aided the company in preparing the petition which led to the certification on May 3, 1979.

II. TRADE ADJUSTMENT ASSISTANCE

The New Jersey TAAC engaged an independent management consulting firm to review the firm's then current position and develop both short and long-term plans for stabilizing the business and returning the company to a competitive position. Studies were conducted on production methods, costs, quality, inventory control and engineering. The marketing review covered existing and potential markets, sales analysis and promotion, pricing policies and customer relations. The financial study reviewed expenses, budgeting and funding requirements to turn the business around.

As a result of these studies, it was determined that Bomar should broaden its market area into the OEM micro processor field as well as other communication markets which show the highest growth potential. To achieve this end, new equipment was needed and market/sales development had to be a major effort.

Bomar had already used to is maximum, the available short and long-term financing and, therefore, could only rely on the Trade Adjustment Assistance program to find its recovery through a direct loan. This was approved and has provided the company with the opportunity to acquire new equipment, develop a sales organization, and provide for adequate inventory to enter the new markets.

Additional consulting experience has been provided to establish a sales representative network and provide a company newsletter to keep customers and sales representatives informed on Bomar's product development. A specialist in the crystal field was also engaged to provide the company with the manufacturing know-how to produce new types of crystals used in the targeted market areas. The new production methods have enabled Bomar to manufacturer high-quality crystals in a variety of sizes.

Bomar Crystal Company

III. EVALUATION

Without the Trade Adjustment Assistance in all likelihood further declines would have resulted accompanied by additional worker layoffs. With the consulting assistance, new markets are becoming available and manufacturing capabilities have expanded to accommodate these markets. These changes could not have taken place without the financial assistance (loan) provided under the Trade Act of 1974. When recovery plan is fully operational, Bomar is expected to increase employment to 96 workers and regain its sales growth.

WIRE CLOTH MANUFACTURERS INC. - MADISON, NJ

I. BACKGROUND

Wire Cloth Manufacturers, Inc. was founded in 1965 and operates as a fabricator of wire cloth or screen parts used in appliances and industrial processes. Most production orders were for small quantities requiring quick deliveries and to accurate specifications.

Sales peaked in 1977 at almost $450,000 but fell considerably in the following two years, due primarily to foreign competition in the fabrication of screens for smoke detectors and imports of high volume products such as extrusion screens for the plastic industry.

II. TRADE ADJUSTMENT ASSISTANCE

The New Jersey Trade Adjustment Assistance Center was instrumental in bringing the Trade Act program to the attention of the company and assisted management in the preparation of a petition which led to their certification in January, 1979.

Based on the TAAC's analysis of the company's needs, a marketing effort was deemed to be the major solution to the company's problems. An outside management consultant was engaged by TAAC to establish a manufacturers' representative sales organization to give Wire Cloth national coverage. Consultant was able to provide candidates and assist in the screening process to select the most qualified representatives. The selected representatives were provided with both written and verbal in-depth sales and motivational training to assure short-term results. A system of review was also established to monitor the representative's performance along with sales goals for each.

At a later date, an engineering study was made on the company's plant layout, methods and productivity improvements. Recommendations were made and adopted by Wire Cloth.

The company was able to finance the changes made in its operations and its cost sharing portion of the consulting assistance through regular channels and, therefore, did not require financial assistance available through the Trade Act program.

III. EVALUATION

It is difficult to measure the benefits to the company at this time because of the downturn in the economy. The new sales representatives have produced new business and as the program further develops, there should be a noticeable increase in sales volume.

The method improvements in their manufacturing process have been adopted but their impact on the cost of production has not yet been measured but certainly has led to more efficient operations.

Wire Cloth Manufacturers, Inc.

While the labor force has not been increased, there have been no additional layoffs.

Management has used the technical assistance provided by New Jersey TAAC to reverse the downward trend and is looking forward to the benefits of this assistance in the near future.

JEROME INDUSTRIES CORPORATION - KENILWORTH, NJ

I. BACKGROUND

This company was formed in 1964 and is primarily a manufacturer of wall-mounted voltage transformers for charging various electronic equipment. Other products include battery chargers for industrial application and voltage converters for use by overseas travelers. Historically, sales were made to manufacturers of electric toys, calculators, video games, appliances and battery chargers.

The company was successful in increasing sales volume reaching a peak in 1977 of $2.5 million. The succeeding two years saw a 28% drop in sales volume and a substantial loss recorded in 1979. Declines were attributed to offshore competition principally from the orient. Most large original equipment manufacturers followed this trend because of price advantages.

II. TRADE ADJUSTMENT ASSISTANCE

The New Jersey Trade Adjustment Assistance Center provided assistance to the firm in the preparation of a petition which was accepted on April 11, 1979 and after investigation, on June 6, 1979, Jerome was certified eligible to apply for assistance under the Trade Act of 1974.

The New Jersey TAAC engaged an outside consultant firm to review the company's marketing, management, and financial situations and prepare a plan and develop strategies to enable the company to compete with imported products. The marketing study resulted in recommendation to specialize in smaller "job shop" orders involving design and engineering problem solving in the development of new products by Jerome's customers. The management review recommended a number of additions to the staff to relieve the owner of certain day-to-day operating details. The financial problems were pinpointed and addressed in the review. These include inventory controls, reporting procedures, cost controls and need of working capital.

Based on the above analysis and recommendations, an acceptable business plan was developed and incorporated in the company's loan application. The application was approved under the provisions of the Trade Act of 1974 and this has provided Jerome with sufficient working capital to carry out the various recommendations of the initial study. Financial assistance could not be obtained through usual sources.

To further assist the company in its recovery, additional consulting assistance is in process to establish management controls, improve quality, revise management structure, refine cost controls and order processing.

III. EVALUATION

The initial consulting assistance was successful in identifying the company's problems and provided specific recommendations. Following its recovery plan, Jerome has improved its operating performance and improved its position.

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Jerome Industries Corporation

The loan enabled Jerome to carry out these recommendations and gave them the needed working capital to acquire inventory, carry accounts receivable and expand its marketing activities.

As a result of this assistance, Jerome has achieved an impressive increase in volume, 43%. One large order was achieved only because of the financial resources provided by the Trade Adjustment Assistance program. Their number of customers has increased from 183 to 208 in the last six months and employees now total 140 as compared with 102 at the time of certification.

We are hopeful that the assistance now being completed will further enhance the company's prospects for continued growth and overcome the impact of imported products.

Hayward-Schuster Woolen Mills, Inc.
Gilboa Street
East Douglas, MA 01516
Winfield A. Schuster, President
(617) 476-7411

Hayward-Schuster is one of several such mills in New England producing woolen and wool blend cloth for apparel and upholstery. A combination of factors including a heavy influx of woolen cloth imports from Italy and the United Kingdom contributed to the company's problems. According to the 1979 U.S. Industrial Outlook, U.S. Department of Commerce, ITA, the value of woolen cloth imports increased by over 132% between 1975 and 1978. It has since receded somewhat but not before damaging our domestic industry.

Hayward-Schuster reluctantly entered the Trade Adjustment Program, preferring originally to solve its own problems. After it became apparent that outside assistance was necessary, the firm qualified for the Program and requested a TAAC project officer to assist in developing a recovery plan. The firm, in attempting earlier to solve its own problems, had already accomplished a survey of operations; and thus management knew the general direction in which to proceed.

Among the findings from the survey, and which would become elements of the recovery plan, was that Hayward-Schuster had purchased a set of looms which turned out to be "lemons". These new looms, which became literally inoperative in time, had severely drained the firms financial resources. A disinterested source estimated that these looms had cost Hayward- Schuster in excess of $12,000,000 in lost production and sales alone. This element, plus foreign competition caused mounting losses and a drastic drop in the number of employees from well over 500 to near 300, at one point. This was especially damaging to the local economy as Hayward-Schuster is a key employer within its region.

The TAAC project officer worked very closely with Hayward-Schuster's managment in developing a recovery plan involving both a loan application and consulting assistance focussing on productivity, although "marketing" was also an important part. The firm sought a $3,000,000 guaranteed loan, negotiated with its factor as the lender, to purchase all new looms to replace the "lemons," and for working capital and complemented by the establishment of internal systems and controls. The loan was closed in December 1981; the first new looms have already been delivered, others are on order. Preparations are underway to provide the company with consultant expertise in computer application of internal systems.

Hayward-Schuster is grateful for the cooperation, service and close working relationship of the TAAC in providing the assistance. The company recognizes that without the help of the Trade Adjustment Program, the mill would likely have been forced to cease operations - it was inevitable.

Lorraine Handbags, Inc.
79 Essex Street
Boston, MA 02111
Charles Pagliarulo, Treasurer
(617) 423-5889

Lorraine Handbags is a small manufacturer of leather and suede handbags and accessories. Originally, its products were sold to mass-merchandisers who, in recent years, stocked an increasing number of lower-priced imports from Taiwan, Hong King and Colombia. According to the 1979 U.S. Industrial Outlook, U.S. Department of Commerce, ITA, imports of leather handbags increased by an estimated 21% from 1973 to 1978. From 1974 to 1979, Lorraine's sales, reflecting this influx of foreign-made handbags, fell by almost 75%. Profit margins evaporated and employment declined from 20 to just 6 production workers.

Analysis of the firm's operations by the TAAC project officer revealed a marketing problem and the need for assistance in that area. The consultant hired for this project confirmed the TAAC officer's feelings that the company had been competing directly with low-end imports and that a new marketing/product strategy was needed for recovery. He discovered, via field research, that Lorraine's handbags were being sold literally side-by-side the less expensive, lower quality imports in chain discount department stores. Obviously, they were not moving because they were losing out against price competition. The Lorraine product, being of somewhat better quality, was in the wrong stores and was being retailed to the wrong group of consumers.

Key recommendations centered around upgrading the retail accounts by changing distribution to include specialty stores, boutiques and "first floor" department stores, rather than mass-merchandisers. The product, also, was substantially upgraded by adding inner liners, designing for more style and fashion, extending the line to new colors, and generally including those elements which will bring a higher price.

The strategy was obviously successful because sales rose from $260,000 in 1979 to $1.5 million in 1981 and there is every indication that sales will exceed $2.0 million for 1982. Profitability has been restored and more employees are being added at regular intervals. Management of Lorraine Handbags admits that the firm would probably be out of business today if it were not for the Trade Adjustment Assistance Program.

York Capacitor Corporation
460 Weaver Street
Winooski, VT 05404
Harold Dubilier, President
(802) 655-2550

York Capacitor was a leading supplier of capacitors, devices used for the storage of electrical energy. Its main customers were flourescent lighting and air conditioner manufacturers. The market for the small flourescent lighting, or "tubular" capacitors was generally lost to the Japanese which dropped prices more than 22% between 1978 and 1980. Persons knowledgeable of the capacitor industry reasoned that Japan was attempting to capture the U.S. market for tubular capacitors with no apparent regard for breakeven or profitability. Management reasoned, therefore, that the firm's recovery depended mainly on the success of the air conditioner or "AC can" capacitor which is much less labor intensive.

With assistance from TAAC, the company submitted a business plan based on the production and marketing of a new-technology AC capacitor. It seems as though a smaller, lighter and less expensive AC capacitor had recently been developed using metallized, polypropylene film instead of paper/foil construction. Because it is not a labor-intensive product and because only "approved" U.S. manufacturers of AC capacitors (of which this firm is one of only eight in total) can supply the major markets, the risk of overseas competition is minimal. Industry anticipated that the new metallized capacitors would soon render the older ones obsolete.

The business plan involved the purchase of specialized machinery needed to produce the metallized capacitors and a financial package to support the purchase. Market development for the new capacitors was seen as almost foolproof as they would directly replace the older type in similar equipment. Also, only two of the eight "approved" AC capacitor makers are producing the new type allowing York to get an early foothold in the market before the others followed.

To support the purchase of machinery and equipment for producing the new product, York, with assistance from the TAAC project officer, submitted an application for a $240,000 direct loan. In having this loan approved by ITA, York was able to leverage an additional $110,000 from other sources.

York Capacitor is now producing the new-technology capacitors which are quickly replacing the obsolete type. The company's share of the AC can capacitor market is now increasing; sales are up dramatically, 25 new employees have been added and more are expected. Mr. Dubilier attributes his company's survival and stability to the expeditious assistance provided by the Trade Adjustment Program.

Mid-Atlantic TAAC

CRESCENT GLASS COMPANY
WEST VIRGINIA

Project Summary

MARKETING, TRAINING,
MANAGEMENT CONTROL SYSTEMS

I. Background

This firm is a manufacturer of illuminating glassware and votive candleholders with annual sales close to $2.0 million. These products are sold primarily to wholesalers in a fairly wide geographic pattern.

Imports from Taiwan and Mexico impacted the firm to the extent that sales decreased by more than 10 percent between 1978 and 1979 and employment decreased by 30 percent between 1978 and 1980.

The firm's financial results were erratic during this period as losses related to decreased volume were experienced.

Problems other than the impact of imports were production inefficiency, inadequate cost controls and poor control of inventories.

II. Assistance

A survey of the marketing position of the firm and an overall analysis of the manufacturing operations were made. Strategies involving expansion of the decorated glassware product, which is less vulnerable to being impacted by imports, and improvements in internal operations were developed.

A training program for workers performing the decorating function was developed and implemented. Systems for improving control of inventories, product costing and cost control were designed and installed.

III. Results

The firm expanded its capacity to produce decorated glassware and, as a result of improvements in production efficiencies and controls, has been able to gain and to maintain a consistent short lead time position with its customers.

Inventories have been reduced and increased turnover rates have resulted in substantial savings. Due to the improved cost controls and product costing systems, the firm has been able to price its products for greater saleability.

In spite of its market dependence on the ailing housing industry, the firm has been able to stabilize its financial position at lower than capacity operating rates.

Mid-Atlantic TAAC

WEXLER KNITTING MILLS, INC.
PENNSYLVANIA

MARKETING AND FINANCE

Project Summary

I. Background

This firm, a sweater manufacturer with sales over $3.0 million, sells its products to brand name manufacturers, national retail chains and wholesalers.

Imports from the Far East impacted the firm's sales to the extent that several major accounts were lost and a 10 percent reduction in sales volume was experienced. This reduction in sales led to a 15.0 percent decrease in the firm's employment.

The firm incurred losses from operations and its working capital position was seriously eroded.

II. Assistance

TAAC assisted the firm's management in the development of a recovery plan with the following strategy:

Expansion of sales force and establishment of an office/showroom in New York

Development of a private label

Participation in large volume programs with national chains

Employment of a full-time designer and use of designing consultant servies to develop a fashionable product line.

Assistance was provided in the preparation of an application for a $1.0 million direct loan to be used for working capital to support the inventories required for the marketing strategy.

III. Results

The firm's sales have approached $5.0 million per year, primarily through participation in the high volume program with national retailers. Employment has returned to levels close to pre-impacted numbers.

The firm is making a profit from operations.

Mid-Atlantic TAAC

IMPERIAL READING
CORPORATION
VIRGINIA

MARKETING, FINANCE

Project Summary

I. Background

This firm, with annual sales over $50 million, manufactures private label denim and corduroy jeans and children's and women's sportswear. The firm's customers are major chain stores and national department stores.

The firm has been severely impacted by imports from the Far East and, as a result, sales decreased by 23.0 percent between 1977 and 1979; in this same period employment decreased 48.0 percent from a level of almost 3000 employees in 1977. The reduced demand for the firm's products forced the closing of several plants.

Losses from operations were incurred with a detrimental affect on the firm's financial condition.

The main problem area to be addressed was marketing.

II. Assistance

The assistance provided the firm centered around financial aid and the development of a marketing strategy. A guaranteed loan of $3.0 million and a direct loan of $1.0 million were secured for the firm to be used for fixed assets to upgrade production facilities and for working capital.

In addition, a marketing study provided the background for the development of a strategy emphasizing a new product line - designer jeans for adults.

III. Results

The new product line has attained a volume that constitutes 50 percent of the firm's business. Overall sales have increased by more than 4.0 percent since 1979. Employment has increased by almost 5.0 percent since production of the new product line began.

The improvement in the marketing position of the firm has resulted in a return to profitable operations and an improvement in future prospects for increases in employment.

Mid-Atlantic TAAC

FASS BROTHER, INC.
VIRGINIA

Project Summary

FINANCE, MIS,
MANUFACTURING

I. Background

This firm, with annual sales of $35 million, is a processor of seafood with other activities in vessel management, seafood restaurant and commercial fishing.

Fresh or frozen products are sold to institutional, retail and wholesale customers throughout continental U.S. and in several foreign markets.

The firm has been impacted by imports from Japanese fishing fleets and, as a result, employment decreased after 1977 by almost 5 percent and financial losses from operations were incurred.

II. Assistance

After analyzing the firm's needs, TAAC assisted in the preparation of a recovery plan consisting of a two-year development and capacity-building program, supported by financing, with the following elements:

Expansion of existing docking facilities and development of new docking facilities

Additional processing and freezing space including construction of an ice plant

Fleet expansion

Construction of a service and repair facility

Acquisition of a processing vessel

Additional working capital required for growth

Seasonal line of credit and letters of credit

Refinancing of existing term debt

Technical assistance for an MIS system.

Assistance was provided by TAAC to obtain the extensive financing to support the plan. A multi-tiered financial package totaling $17,750,000 was put together from the following sources:

$1,500,000 from Industrial Revenue Bonds

$3,050,000 from a local bank

$ 550,000 from direct EDA loans

$12,650,000 from private investors and other government funding programs.

III. Results

The firm's sales have increased by 33.0 percent over the period 1977 through 1980. Employment has increased in the same period by 42.0 percent to a high of 365 employees.

The firm has returned to profitability and is in a much more stable financial position.

Technical assistance to develop computerized inventory controls and to perform sales analyses are expected to be provided in the near future.

Mid-Atlantic TAAC

LONDON KNITTING CO., INC.
PENNSYLVANIA

Project Summary

MARKETING, FINANCE
MANAGEMENT CONTROL SYSTEMS

I. Background

The firm manufactures men's, women's and children's clothing in wool and acrylic fibers and tennis wear. The manufacturing process runs from purchase of raw materials to shipping finished products. Merchandise is sold through a selling agent to middlemen who put finishing touches on garments and then ship to retailers.

Imports mainly from the Taiwan/Hong Kong area impacted the firm between 1979 and 1980 with the following results:

Sales declined by 12 percent from almost $3 million.
Employment declined by 23 percent to 81 employees.
Heavy operating losses were incurred.

Other area of concern: Due to management's day to day involvement with operating activities, more emphasis was needed on market analysis and fashion trend analysis to avoid inventory problems.

II. Assistance

Assistance was provided in the areas of financial planning, marketing study and operations analysis: cost and inventory controls.

Broad based strategies were developed aiming at expanding existing sales levels and improving operating efficiency by:

1) developing and marketing a new line of active sportswear - warm-up suits for men, women and children

2) reestablishing traditional sweater business at an acceptable level through emphasis on styling and sales to larger chains

3) implementation of in-house control procedures to control/monitor internal costs (specifically inventory costs)

4) lay groundwork for eventual penetration into the international apparel market.

A direct loan of $1.0 million was applied for and secured to be used for fixed assets and working capital.

In addition, a consultant's study of operations with emphasis on cost control was provided.

III. Results

As a result of the assistance provided, the firm's sales have increased by

50 percent from 1980 to 1981 to volumes that permit efficient operations.

Employment has increased and became stable at a level near 100 employees, an increase of 36 percent over the low figures in 1977.

Inventories have been reduced and the resultant improvement has contributed to a reduction in operating costs. The firm returned to a profitable operation in 1981 with a large swing from an operating loss in 1980.

The study of the firm's operations led to improved efficiencies in the sewing operations with savings of approximately $65,000.

Mid-Atlantic TAAC

WILLITS SHOE COMPANY
PENNSYLVANIA

Project Summary

MARKETING, MANUFACTURING, FINANCE, MANAGEMENT CONTROL SYSTEMS

I. Background

This firm, with annual sales close to $6 million, manufactures boys' and girls' shoes for private label sales to national retail chains.

Import penetration of children's shoes, increasing year by year, averaged 45 percent of the market in 1979. The impact of imports on the firm's sales and employment resulted in a 15.0 percent reduction in units sold from 1977 to 1980 and a 11.1 percent reduction in employment.

The firm's principal financial problems were a heavy debt structure, large interest expense and slow turning receivables.

Additional problem areas included aging production facilities, less than optimum inventory turnover and lack of some appropriate control procedures.

II. Assistance

A survey including market studies, an in-depth analysis of the firm's financial condition, an audit of manufacturing capabilities and an assessment of management was made. This study provided the informational background for the strategic planning needed for a recovery plan for the firm.

The marketing strategy involved increasing the firm's retailer base by 25 percent over a three year period, widening the firm's geographic sales strength outside of the Mid-Atlantic area and increasing the value of key house accounts.

Manufacturing and management strategies included modernizing production facilities and improving management information and other control systems.

A loan application for $1.0 million guaranteed loan for fixed assets and inventory expansion was processed.

III. Results

Firm has upgraded its sales force by replacing marginal producers and has increased its large wholesale private label business. Service to retailers has been improved through establishment of a same day shipping policy.

Employment has increased in 1981 by almost 5.0 percent over 1980.

Technical assistance in computerizing the inventory system is expected to be provided in the near future.

Mid-Atlantic TAAC

FLASH TRIMMING COMPANY
PENNSYLVANIA

Project Summary

MARKETING, INDUSTRIAL
ENGINEERING, FINANCE,
MANAGEMENT CONTROL SYSTEMS

I. Background

This firm, with annual sales of $2.5 million, designs and manufactures novelty trimming and embroidery for men's, women's and children's jeans. The products are sold to brand name accounts throughout the U.S.

Imports from the Hong Kong area impacted the firm causing a reduction in sales of almost 10 percent and a 15 percent reduction in employment.

Reduced sales volumes resulted in financial losses from operations for the firm.

Additional problems that required attention were low productivity in the work force and inadequate internal financial controls.

II. Assistance

Assistance in the form of market studies, an analysis of manufacturing operations and an assessment of existing internal controls was provided to the firm. A comprehensive recovery plan was developed with strategies that included:

Improving production efficiency and costs by the development and installation of a piece rate incentive plan for the workers

Realigning plant facilities for greater efficiency

Designing and installing a forecasting and budgeting system

Increasing sales by developing two new product lines

Expanding the existing marketing organization

In addition, the firm was assisted in applying for a $350,000 direct loan to be used for fixed assets and working capital.

III. Results

The piece rate incentive system has been installed and is expected to provide savings in excess of $125,000 annually.

The internal controls over the firm's operations have been greatly improved with resultant cost reductions and effective systems for managing the business.

Sales have increased by 25 percent to $3.0 million in 1981.

Employment has increased by 7 percent to 140 employees.

From 1980 to 1981 the firm's financial results have swung from a loss to a profit from operations.

NEW YORK STATE
TAAC
Trade Adjustment
Assistance Center
Hillside Building
4500 Old Vestal Road
Binghamton, New York 13903
607-729-2201

Engagement Summary

Ithaca Gun Company

Shotgun Manufacturer — Finance, MIS, and Engineering

Background:

Ithaca Gun Company is a manufacturer of high quality sporting firearms that suffered a $5 million decline in annual sales due in large part to steadily increasing sales of imported firearms. The company's major products consist of sporting shotguns of various gauges used for hunting, trap and skeet shooting.

Objective:

The objectives of this engagement were to assist Ithaca Gun Company in returning to profitability and maintaining their employees by securing the necessary financing and providing skilled consulting services. NYS TAAC worked closely with the firm's top management in developing a strategic business plan calling for financial assistance, engineering/new product development and implementation of an improved Management Information System.

Components of the Engagement:

NYS TAAC staff members in conjunction with the management of Ithaca Gun evaluated the working capital needs of the company and prepared a Trade Act loan application. The seasonal and unique nature of this business required special attention to cash flow projections.

An outside consulting firm specializing in electronic data processing was selected to assist the firm in the installation of a much improved in-house management information system utilizing a data base concept.

Currently the NYS TAAC is developing an engineering proposal such that Ithaca Gun can soon start production of an innovative, newly designed trap gun.

Summary:

With the disbursement of the working capital loan ($750,000), the company has been better able to schedule production and minimize the seasonal industry cycles. The MIS program is already generating more timely, reliable information which will result in continuing cost savings. The third phase of the program is nearly in place and should result in substantial sales increases. In addition to the new trap gun, Ithaca has developed another new hunting shotgun that has generated considerable excitement in an industry that is often characterized as old-fashioned and non-responsive.

As a direct result of the assistance provided under the Trade Act, Ithaca Gun has been able to maintain its market share in the face of a severe industry downturn.

NEW YORK STATE
TAAC
Trade Adjustment
Assistance Center
Hillside Building
4500 Old Vestal Road
Binghamton, New York 13903
607-729-2201

Engagement Summary

Macler Industries, Inc. Marketing and Manufacturing

Background:

Macler manufactures cast iron products sold to original equipment manufacturers. Its annual sales of 3000 tons declined due to imports of compressor, economizer, EGR valve and carburetor castings. It also suffered a secondary loss because many of its clients were also import impacted.

Objective:

The objective of the New York State Trade Adjustment Assistance Center's participation was to assist the firm in developing a strategy to increase sales. To do so would require the protection of existing sales as well as the development of new markets.

Components of Engagement:

The New York State Trade Adjustment Assistance Center's staff examined the firm's facilities, systems and marketing programs. It also met with Macler's key managers to assess the firm's ability to develop new products and to identify major growth obstacles.

A foundry specialist was also retained to evaluate the firms capabilities and to recommend a growth direction.

Summary:

The result of this effort identified the need for Macler to develop new processes. Without this, it could not remain competitive or develop adequate market diversification. It was also established that a long range coordinated program was essential and that outside engineering was required to execute it. The need for improved marketing techniques and improved information systems was also established.

An engineering consultant was engaged to assist in the installation of two new systems. One, the vacu-shell system, has been the first installation of its type in this country and sample products are now being produced. An economic analysis determined that the second system be phased to conform with sales. It permits Macler to produce massive heat exchanger castings. The prototype phase layout is now being replaced with the next phase and subsequent phases will take place as sales demand.

Marketing tools have been developed which are now in use and a computer has been installed. Manual information systems are systematically being converted and new systems will soon be designed and added.

The engineering consultant is still active and now concentrating on plant layout, material handling, ventilation and pollution control improvements.

The firm is pleased with its progress and feels that this would not have transpired had it not been for the New York State Trade Adjustment Assistance Center's assistance.

NEW YORK STATE
TAAC
Trade Adjustment
Assistance Center
Hillside Building
4500 Old Vestal Road
Binghamton, New York 13903
607-729-2201

Engagement Summary

Utica Duxbak Corp.

Outdoor Sportswear Manufacturer Production and Marketing

Background:

Utica Duxbak Corporation, founded in 1904, is primarily engaged in the manufacturing and selling of hunting, fishing and outdoor clothing. The firm sells direct to retail accounts through its own sales force and manufacturer representatives.

Annual sales and employment peaked in 1978 at $4,425,000 and 100. However, sales and employment declined by 1980 to $4,000,000 and 88. This decline is attributable to the importation of cheaper competitive clothing from foreign exporters and domestic manufacturers having sportswear made for them abroad.

Objective:

A review of the firm established the goals of helping the firm formulate a strategy for improving profits. The strategy was designed to reduce manufacturing costs through increased operating efficiencies; increase sales through expanding the market base and obtain a fixed asset and working capital loan to finance the increased sales derived from the marketing effort.

Components of Engagement:

A key component of this engagement was the evaluation and selection of consulting firms to reengineer the firms pant production line and develop a comprehensive marketing plan.

The reengineering work included:

1. Analyzing the various styles of pants being manufactured to determine the potential to standardize particular operations.

2. Developing an optimal pant line production layout which will optimize operators, floor space, workstations and equipment requirements.

3. Design an incentive system to yield actual average earnings sufficiently high to permit the firm to compete successfully for employees in its labor market and produce maximum productivity.

4. Develop economical and expeditious material handling procedures.

The marketing plan included:

1. Identification of new markets with a plan for penetration.
2. New product development.
3. Establishment of a profitable corporate marketing direction.
4. Image building.
5. Determination of market share available to the firm.

Summary:

As a result of the reengineering of the pant production line the firm has experienced a cost reduction of 15% in one year. As sales volume increases greater reductions are anticipated.

As a result to the comprehensive marketing plan the firm has begun to regain lost volume and attacked new markets through the establishment of factory outlet stores throughout the Northeast.

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With the assistance of the New York State Trade Adjustment Assistance Center the firm obtained a direct fixed asset loan of $157,500 and a direct working capital loan of $740,500 from the Economic Development Administration.

MIDWEST TAAC ENGAGEMENT SUMMARY

CLIENT: Brooks Leather Sportswear (BLS)
14511 W. 11-Mile Road
Oak Park, Michigan

BACKGROUND:

BLS manufactures motorcycle leather sportswear. Between 1977 and 1979, BLS sales volume increased from $1.8 million to $2.4 million. It's operating profit for the same time period increased from $185,000 to $306,000. In 1979, BLS had 30 employees. In January of 1980, BLS lost its Harley-Davidson account which represented 30% of total sales. Harley-Davidson started buying like products made in Taiwan. Retailers of motorcycle leather sportswear were importing directly from Taiwan and Korea. Even though quality of imported sportswear was not as high as that of BLS, the motorcyclist was not always that discerning and he purchased the lower-priced import.

As a result of the loss of Harley-Davidson account and declining retail sales, total sales volume and earnings were adversely affected. BLS came to MIDWEST TAAC to seek consulting help on how to avoid further sales decline, but more importantly how to increase sales volume and make the company more competitive.

BLS management had some practical thoughts on how to improve sales; management wanted to institute a nationwide manufacturer's representative network, advertise nationwide, and sell to the European market. Independent input was sought from the MIDWEST TAAC to validate management's ideas and to help in implementing them.

OBJECTIVE:

The objective of this engagement went beyond evaluating management's marketing thoughts. Financial strategies, policies and controls were to be evaluated. Plant layout, work flow and production scheduling was to be evaluated.

APPROACH:

MIDWEST TAAC staff consultants had on-site discussions with the management of BLS, after a tour of the plant.

Some of the findings, based on plant tour, discussions and in-depth analyses, are:

Marketing

- o Confirmed need for nationwide manufacturer's representative network. Having dealers only in the midwest was too narrow as a sales base.
- o Confirmed need for advertising in media that have nation-wide access. This effort required the assistance of an advertising agency.
- o The requirement for an in-depth study of the European market to determine the market potential for BLS. This study, estimated at $20,000, was to be financed through technical assistance from ITA.

Production

- o Plant layout needed some improvements
- o Production scheduling and work flow needed to be improved upon.
- o More efficient inventory control systems needed to be instituted.

Estimate of production-related technical assistance was $20,000.

Finance

- o Need for operating budgets
- o Need to improve BLS equity via greater retention of earnings
- o Evaluation of lease/purchase of a computer

SUMMARY:

BLS received technical assistance in these amounts:

- $20,000 for export market studies
- $20,000 for production-related improvement studies
- $2,000 for evaluating the need for an in-house computer, and evaluating whether to buy or lease once the need is established.

BLS had been able to implement some of the adjustment plan findings. Some manufacturers representatives have been signed on. More are being signed on around the country. BLS is committed to exporting. The more noticeable results of MIDWEST TAAC's association with BLS are:

- o Improved sales in 1981. Total sales volume: $2.6 million.
- o Increased employment: Not only has BLS been able to retain the 30 employees it had at the time it came to MIDWEST TAAC, BLS has increased its employees roll to 32.

MIDWEST TAAC ENGAGEMENT SUMMARY

CLIENT: Cleveland Motive Products, Inc.
Manufacturer of Automobile and Truck Parts for the Aftermarket

BACKGROUND:

Cleveland Motive Products, Inc. (CMP) was founded in 1953 as a distributor of automotive and truck components for the aftermarket. The present owner purchased the company in 1974.

U-Joint, Inc. (UJI) was formed in 1977 to produce U-joints for the automotive market. U-joints provide flexibility to the drive train between the transmission and the differential of rear-drive vehicles.

CMP markets U-joints which it purchases from UJI. It also markets hanger bearings which it assembles from parts purchased from outside vendors. Hanger bearings are used to support the drive shaft of trucks and some larger passenger cars. Recently, a line of timing components has been added to the CMP product lines. These are presently purchased for resale through CMP's distribution system.

UJI's only product is U-joints that it sells to CMP and to its own customers on a private label basis.

Sales, profits, and employment were as follows:

	1978	1979	1980
Sales (Million $)	5.1	6.5	5.4
Profits (Thousands $)	237	343	(209)
Employment (Average)	62	67	69*

*As of October 1, 1980, actual employment was 50

Hanger bearings accounted for about 63 percent of sales.

Components of the Engagement

MIDWEST TAAC staff members conducted marketing, manufacturing, and financial analyses of the firm's operations.

Three overriding problems existed:

- The firm's products were import impacted.
- A recession existed in the firm's only market, the automotive industry.
- A transition was taking place from rear-drive to front-drive vehicles.

In addition, the firm was having startup problems with a high-speed transfer machine that could produce 17 U-joints a minute. The company's ability to survive in the U-joint market depended on the successful operation of this machine.

Strengths that the company had were a good distribution system and capable management and marketing personnel.

The strategy which MIDWEST TAAC assisted CMP in developing included:

- Remain in the hanger bearing market and expand the line to include popular sizes and types not now produced.
- Remain in the U-joint market, concentrating on bringing the transfer machine up to the required production rate.
- Expand the present line into high-mortality engine, drive line, and chassis parts.
- Enter the front-wheel drive market, starting with rubber boots and expanding into metal parts at a later date.
- Enter the export market, initially in Venezuela and other Latin American countries where contacts had already been established.

These projects were forecasted to create potential sales of about $20 million by 1984.

Implementation

To implement the above strategy would require:

- Technical assistance in the form of a market study to determine and prioritize the new products to be added, at an estimated cost of $25,000.
- Technical assistance in the form of services of an industrial engineer to redesign the layout and work flow planning at UJI, at an estimated cost of $12,500.
- Financial assistance in the form of a guaranteed loan for $2,400,000, of which $1,775,000 would be allocated to machinery and equipment and $645,000 to working capital.

It is expected that implementation of the proposed strategy would result in employment increasing from its 1980 level of 50 to 90, 120, and 152 in 1982, 1983, and 1984, respectively.

2/17/82

MIDWEST TAAC ENGAGEMENT SUMMARY
by Tom O'Leary

Apparel Manufacturer | Information Systems

DALTON INDUSTRIES, Inc. Willoughby, OH, | Contact: Mr. Ed Young
VP, Administration

BACKGROUND:

This large firm designs, manufactures, and markets women's sportswear. Increased imports of all apparel, combined with shifts in market preference, caused a sales drop in 1979 of more than 20%.

OBJECTIVE:

The major objective of this engagement was to assist the firm in improving its ability to react more promptly to market trends and to actual sales.

COMPONENTS OF THE ENGAGEMENT:

After conducting a comprehensive review of the companies marketing, managerial and operational practices, the TAAC engaged consultants to assist the firm on two pivotal projects.

The first was a $33,000 project to develop techniques to improve sales forecasting so as to reduce the production of unwanted merchandise that would have to be marked down at the end of a season.

The second was a $55,000 computer programming project to redesign the company's computer data base to accommodate the first project and also to accommodate other future improvements in management information systems.

SUMMARY:

As a result of the company's efforts, in conjunction with the trade adjustment assistance provided, the following has occurred. The company has increased employment to 1800 from the 1400 previous peak and from 1100 at the low point.

- Sales have returned to the previous level
- Profitability has been enhanced
- Company management is receiving better information with which to respond to market conditions.
- Further improvements are being made in production control and in materials management.

NOTE: The company has authorized the use of its name in this report but does not permit release of sales or profit figures.

RESULTS

The firm made a loan application in Washington. The loan application committee suggested several changes in the application be made. The firm will resubmit its application before April 1, 1982. Technical assistance for a marketing study and for industrial engineering will also be applied for.

Little World, Inc.
112 W. 34 St.
New York, N.Y. 10001

Friedrich Knitting Mills, Inc.
8400 73 Ave.
Glendale, N.Y. 11227

Contact person: Ed Stalzer, V.P.
(212) 894-4500

Product: Knitted Infants and Childrens Wear

When Little World was certified in 1979 its sales were $4.9 million down from sales of $5.9 million in the previous year. Employment at the time of certification was 186. Imports from the Far East had impacted the firm.

Metropolitan NY TAAC diagnosed Little World's problems and assisted them in the development of its business plan which culminated in May 1980 with Little World receiving an $800,000 working capital loan from the EDA. The firm also received implementation technical assistance which included a marketing study and merchandising plan, and an engineering study with emphasis in the knitting areas, pay incentive program and production scheduling.

This implementation technical assistance which was supplied by Metro NY TAAC at a cost of $70,000 became the basis upon which Little World was able to adapt to the changing market place. For example, Little World diversified its production by marketing woven bottoms that coordinated with their knitted tops. This has made their product more salable. The channels of distribution were also diversified to include chain stores. In 1981 sales made to the chains were $3,000,000.

In addition, the technical assistance provided in the production area alone resulted in a one year savings at least equal to the $70,000 spent on the total technical assistance.

The benefits of the loan produced an obviously better cash flow, that allowed the company to remain successfully in business. The firm has gone beyond its sales projection of $7.5 million to $8 million while employment increased to approximately 250 in 1981.

SDC:lk
2/17/82

Dawson Industries Inc.
1350 Broadway
New York, New York 10001

Contact Person: Max Angel, Pres.
(212)695-9215

Product: Ladies Lingérie and
Men's, Ladies and Children's Actionwear

When Dawson Industries was certified in 1977 its sales were $4.5 million and articles produced were 855,000 dozens. Employment at the time of certification was 385. Imports from Overseas had impacted the firm.

This Trade Adjustment Assistance Center assisted Dawson Industries in the development of its loan application which culminated in November 1979 with the firm receiving a $1,000,000 working capital loan from the EDA. The firm also received implementation technical assistance which included an engineering study with emphasis on plant layout, pay incentive program and production scheduling.

This implementation technical assistance which was supplied as a co-operative venture between Metro NY TAAC and Southeastern Regional TAAC at a cost of over $100,000 became the basis for plant expansion from 40,000 sq. ft. to 132,000 sq. ft. This resulted in greater plant capacity and efficiency.

The benefits of the loan produced an obviously better cash flow, that allowed the company to expand and diversify its business, and increase its production and reduce unit costs. Instead of floundering, the business grew. Sales increased from $4.5 million in 1977 to $18 million in 1981, while employment increased from 385 to 450 during that time.

Microfilmed From Best Available Copy

JOLIE HANDBAG, INC.
416 West 13th Street
New York, N.Y. 10014

Contact Person: Gerald Manowitz, President
212-691-5265

Product: Ladies Handbags

When Jolie Handbags, Inc. was certified in December 1978, its sales were $2.9 million and articles produced were 1,375,000 units. Employment at the time of certification was 140. Imports from Overseas had impacted the firm.

Metropolitan N.Y. TAAC diagnosed Jolie Handbag's problems and assisted the firm in the development of its loan application which culminated in November 1979 with the firm receiving a $850,000 working capital loan and $150,000 fixed asset loan from the E.D.A..

Jolie Handbag, Inc. has also received Marketing technical assistance.

This assistance which was supplied as a co-operative venture between Metro N.Y. TAAC and the National Handbag Association became the basis upon which Jolie Handbag was able to adapt to the changing market place. For example, Jolie Handbag changed its market field from discount stores (low price handbags) to shoe and apparel chains (moderate price handbags) who are more fashion oriented.

The benefits of the loan and the technical assistance allowed the firm to increase its sales from $2.9 million in 1978 to $7.6 million in 1981, while employment increased from 140 to 269 during that time.

The management of Jolie Handbag, Inc. believes that the firm would not be in business today, if it were not for the Trade Act of 1974.

KOLTIS ENTERPRISES, INC.
780 East 135 Street (South Bronx)
Bronx, N.Y. 10453

Product: Ladies' Shoes

Contact Person: John Koltis, Pres.
212-993-4900

When Koltis Enterprises, Inc. was certified in October 1977, its sales were $3.8 million and employment at the time of certification was 100. Imports had adversely affected the firm.

Metro N.Y. TAAC diagnosed Koltis Enterprises's problems and assisted them in the development of its business plan which culminated in October, 1981 with Koltis Enterprises receiving a $790,000 working capital loan and a $210,000 fixed asset loan from the EDA. The firm also received implementation technical assistance which included a marketing and engineering study with emphasis on plant layout, pay incentive program and production scheduling.

This implementation technical assistance which was supplied by Metro N.Y. TAAC and an outside consultant at a cost of over $80,000 resulted in savings, in the production area alone, at least equal to the over $80,000 spent on the total technical assistance.

The benefits of the Trade Act produced a better cash flow and production efficiency that allowed the company to remain successfully in business. The firm increased its sales from $3.8 million in 1977 to $5.2 million in 1981 while employment increased from 100 to 150 during that time.

Dame Belt & Bag Co., Inc.
636 Eleventh Avenue
New York, New York 10038

Product: Belts & Handbags

Contact Person: Jeffrey Mehler
212-581-8030

Amid the current slump in the garment and allied needle trades industry, Dame has continued to increase its sales since being certified in 1976.

Sales will have increased from 3 million in 1976 to approximately 15 million dollars by the end of 1982. N.Y. Metro TAAC has helped Dame perform this dynamic turnaround through assisting them in obtaining an interim Small Business Administration loan of $300,000, plus loans from EDA and technical consulting assistance.

The job impact realized by Dame and New York City through the Trade Act of 1974 assistance was 200 jobs saved and an additional 135 added jobs. Now, Dame employs a total of 335 people and employs hundreds more through the contractors it utilizes. Also, since Trade Act help, the company has seen earnings jump 23 times since 1977.

From a total loan program of one million dollars ($600,000 F.A., $400,000 W.C.) through EDA - Dame has been able to purchase new production equipment, purchase raw materials at volume discounts, and increase it's finished goods inventory. All of this has helped to reduce costs, and enabled the firm to service it's customers better. In addition, Dame added an Oleg Cassini designer line and also diversified into small leather goods (wallets, keychains, etc.) thus finding a niche which the imports did not affect.

Dame's performance is an inspiration to the entire handbag industry and to all troubled firms - especially when we take into consideration that they have amortized nearly $750,000 of their $1,000,000 loan.

KELLY SLAX, INC.
1384 Broadway
New York, N.Y. 10018

Product: Men's and Women's Pants

Contact Person: Joseph Kelly,
President
212-575-9070

When Kelly Slax was certified in 1980, its sales were $6.3 million, down from sales of $10.7 million in the previous year. Direct employment by Kelly and the contractors it used was 528 in fiscal 1979, down from employment of 954 in the previous year. Imports from the Far East had seriously affected Kelly's business and chances for survival.

Metropolitan New York TAAC diagnosed Kelly Slax's problems and business opportunities and assisted the firm in the development of its strategic marketing plan for recovery. These efforts culminated in September 1981 with Kelly receiving $1,500,000 of financial assistance, of which $1,000,000 was a direct loan by EDA and $500,000 was a bank loan guaranteed by EDA. The proceeds of the loan were used for fixed assets ($285,000) and working capital ($1,215,000).

The benefits to Kelly of the trade adjustment assistance program were significant...survival and growth. Because a prerequisite to obtaining financial assistance was the submission of a written adjustment strategy, Kelly crystallized into a consistent strategy what had previously been only ideas. In addition, the prospect of Kelly's obtaining financial assistance influenced the bank to liberalize the existing arrangement with Kelly at a time when banks were generally retrenching their portfolio of loans to the apparel industry. Later when Kelly received notification from EDA of approval of its loan application, Kelly was able to get increased trade credit to buy raw materials and generate enough sales to remain healthy. When its loan closed in September 1981, its financial condition and chances for growth were obviously further enhanced.

Despite financial assistance, Kelly probably would not have survived if it had not had an excellent strategic marketing plan. This plan led to the firm's adjusting to negative conditions caused by imports. Kelly adjusted by significantly diversifying into other product segments and distribution channels. From 1979 through 1981, Kelly's reliance on menswear decreased 97% of company sales to 51%, and womenswear increased from 3% to 49%. From 1979 through 1981, Kelly's reliance on chain store and catalogue channels decreased from 100% of company sales to 56%, and specialty department stores increased from 0% to 44%.

The benefits of trade adjustment assistance to Kelly were survival and growth, resulting from successful trade adjustment and increased working capital. Since becoming certified, sales have increased from a depressed level of $6.3 million to $11.2 million and employment from 528 to 838.

TAAC continues to assist Kelly Slax in its trade adjustment. Kelly will receive an estimated $125,000 of additional technical assistance. The assistance will be to improve productivity and lower costs in production and distribution operations, and to identify profitable market segments for further diversification. Because Kelly's manufacturing facility is in Georgia, this technical assistance project will be a cooperative one involving Metro N.Y. TAAC, Southeastern TAAC, and Kelly.

SOUTHEASTERN TAAC ENGAGEMENT SUMMARY

I. BACKGROUND

Dawson Industries, Inc., is located in Dawson, Georgia with sales and administrative offices located in New York City. The firm currently engages in the manufacture, sales, and distribution of men's, women's, and children's athletic/active sportswear in knit and woven fabrics of cotton and synthetic fibers. Its product line in the past also included sleepwear and panties. Today, their products are sold to speciality stores, department stores, and discount chains either by independent representatives or company salesmen, depending upon geographic territories.

After enjoying success in the early seventies, the firm began to experience serious competition from imported ladies' and children's apparel products, particularly sleepwear and panties, from the Far East. Between 1974 and 1976, Dawson Industries suffered a 34 percent decline in employment (from a high of 585), a 20 percent decrease in sales dollars (from a high of $5.8 million), and a 15 percent decline in production.

II. ASSISTANCE PROVIDED

The firm developed a new business strategy to combat the effect of imports and to regain its competitive position. Working with the New York TAAC, Dawson Industries received a $1 million Trade Act loan to provide working capital for repositioning its sportswear line to include higher prices and more fashion-oriented garments. The firm was able to increase sales from $4.6 million in 1976 to almost $11.7 million in 1979 based on this new strategy.

Despite this significant increase in sales volume, Dawson was unable to achieve adequate profit performance. Because of continued import competition, the firm could not raise its prices and had to focus on manufacturing cost reductions as a means of restoring acceptable profit levels.

The Southeastern TAAC assisted the firm in formulating a strategy for improving profits, with particular regard to reducing manufacturing costs and increasing managerial efficiency. Based on an operational audit performed by the Southeastern TAAC, several opportunities were uncovered. To improve operations, the Southeastern TAAC recommended the installation of a fully integrated production system; the re-engineering of the sewing room to include the development of new piece rates and cost reporting; supervisory training and new line balancing methods; modification of existing product costing procedures to allocate direct overhead and materials cost more accurately; a review and improvement of plant layout; and the establishment of improved operating budgets.

The Southeastern TAAC provided technical assistance toward achieving these ends by engaging private consultant contractors to address the areas of production control, product costing, and sewing room engineering, while the firm used its own resources to effect other of the recommended changes.

III. RESULTS

Dawson Industries has been successful in achieving its goals. Sales in 1981 reached $18.0 million. The cost reduction program in the manufacturing area can document savings in excess of $100,000 annually, contributing to a return to acceptable profitability. Employment in Dawson, Georgia has returned to previous levels, and excellent prospects exist for an expansion which will add 100-150 new jobs in an economically depressed area. Jobs have also been created in other manufacturing firms which act as a subcontractor to Dawson in producing garments to meet sales opportunities.

SOUTHEASTERN TAAC ENGAGEMENT SUMMARY

I. HISTORY/PROJECT BACKGROUND

The Keane Monroe is a North Carolina Corporation, manufacturer of automatic door operators. Historically, the firm experienced sales levels of $3 million and total employment of 62 persons. The firm suffered a sudden 22% decline in sales volume when Besam, part of a large Swedish conglomerate, purchased Keane Monroe's largest distributor for distribution of Besam's own automatic door operator products.

II. TRADE ADJUSTMENT ASSISTANCE PROVIDED

The Southeastern TAAC conducted an audit of the firm's operations. A strategic plan was developed with the following objectives: 1) develop new products to fill significant product line gaps and improve the price competitiveness of certain existing products; 2) improve the visibility of the Keane Monroe name and gain acceptance by major chains and architects; 3) reduce the dependence on Northeast markets by expanding sales in other areas of the country; and 4) strengthen market planning and management programs.

Keane Monroe committed its requisite strength to many of the critical tasks necessary for recovery; however, the company needed assistance in several areas. The company's 1979 marketing plan was rendered useless by the unexpected nature of the sales decline. The firm needed an objective examination of its market opportunities and some reduction with respect to geographic and product concentration. Marketing expertise was provided to the company to conduct a market planning study for the company. The project consisted of four phases: 1) Review and analysis of Keane Monroe's marketing and the market; 2) Development of marketing objectives and strategies; 3) development of detailed marketing action plans; and 4) estimates of potential sales and marketing cost. The plan was favorably received by the ownership of Keane Monroe. To completely implement the plan on the outlined timetable, some new financing was needed. After reviewing the firm's strategic plan, the Regional Office of EDA accepted the plan and agreed to provide additional assistance.

The company and SETAAC worked out an extended timetable and the company proceeded to implement the plan.

III. RESULTS

It has been two years since the company has received Trade Adjustment assistance. Much has been accomplished. As a result of the market planning provided by the TAAC, and the effort put forth by the management and employees of Keane Monroe, the company developed three new products and brought them to market: 1) a versatile overhead concealed electrohydraulic operator, the Series 4500, which is said to be the quietest in the industry; 2) a heavy duty slider operator, the Series 7000, which has sold very well; and 3) a light duty operator, the Series 100, which is inexpensive enough for residential use. Two new regional sales managers were hired, and the sales efforts in the Midwest, northern California, and Southeast sales regions have been successful. In 1981 the company enjoyed sales of approximately $3.6 million and registered an after-tax-profit of $103,292, despite interest payments of $85,000 above the budgeted amount (due to unexpectedly high prime interest rates). This represents a 24% increase in sales and a 686% increase in after-tax-profit. The future looks bright for Keane Monroe. It has more than regained the business lost in the Northeast, has new products with customer appeal, and has regained its profitability.

TRADE ADJUSTMENT ASSISTANCE ENGAGEMENT SUMMARY

I. HISTORY/PROJECT BACKGROUND

The Joy Footwear Corporation, located in Hialeah, Florida was founded in 1971 as a manufacturer of casual footwear and athletic shoes generally made of canvas upper components and rubber soles. We were a relatively successful company and by 1977 had reached $9 million in sales, comprised mostly of canvas basketball shoes. We employed approximately 350 persons.

In the years following 1977, the nylon and vinyl jogging shoe became very popular, and the market for basketball shoes and canvas shoes in declined. Joy Footwear began to manufacture jogging shoes but was unable to attain any degree of success in this market because of the market being flooded with cheaper imports from Taiwan and Korea. Price wise, Joy Footwear was unable to compete with the imports because it lacked the ability from a productivity standpoint to make up the difference between American and (cheaper) foreign wage rates.

By 1979 sales had declined from the 1977 high of $9 million to $4.5 million. Employment was down from 350 to 140. As the result of declining sales and unprofitable operations, the company was financially weak and unable to borrow money in the private sector.

II. TRADE ADJUSTMENT ASSISTANCE PROVIDED

In 1979, Joy Footwear Corporation filed a request for Trade Adjustment Assistance with the Department of Commerce. The firm was certified as eligible to request assistance and did so by requesting help in the preparation of a strategic business recovery plan.

A well-known national consulting firm was provided through the Trade Adjustment program to assist the company in developing a strategy to overcome the problem of import impaction. The consultants audited all company operations to identify the problems and opportunities of the firm. The consultants, together with the management of Joy Footwear, prepared a tactical plan which included the following elements:

1. A consolidation of product lines, with concentrated effort in certain product lines and market segments;
2. An improvement in both the quality and quantity of the sales force;
3. The purchase of production equipment, including two additional injection molding machines, which would increase the plant output to levels consistent with sales projections; and

4. The installation of sewing machinery work aids and revision of the work measurement system to improve productivity and reduce labor costs.

The plan was submitted to the Department of Commerce and subsequently approved, thus allowing Joy Footwear to receive additional technical and financial assistance to implement its recovery plan.

Financial assistance was provided through the Trade Adjustment Assistance Program to support Joy Footwear's strategy. A combination guaranteed/direct loan was approved for $1.75 million to supply working capital for the new marketing strategy and to purchase the new equipment for the productivity improvement strategy. Technical assistance was approved to provide 12 person-months of on-site industrial engineering expertise to restructure to work measurement standards and install machinery work aids.

III. RESULTS

As a result of the production efficiency program, manufacturing costs were reduced by 15 percent. Some productivity savings were passed along to the employees allowing them to increase their hourly earnings. The technical assistance, together with the new working capital, provided the basis of Joy Footwear's active pursuit of the new jogging shoe market.

Sales for 1981 were $16 million — up from the 1979 low of $4.5 million. The company now employs 600 persons, many female, mostly Spanish-American workers in the Hialeah-Miami area.

Type of Trade Adjustment Assistance
Guaranteed Loan: $1,500,000
Product Refinement Asst.: $18,500

Firm Name: Amplifone Corporation
Address: P. O. Box 4340
Brownsville, TX 78520
Telephone: 512/541-3461
Contact: Mr. T. K. Handing, Sr., former President

Amplifone Corporation had historically provided components to manufacturers of television sets. Imported components, particularly from Japan, had captured virtually all of the firm's markets. Amplifone took definite steps with its own resources to try to combat this situation: the firm moved from Illinois to Brownsville, Texas to reduce operating costs while diversifying into consumer electronics and into the design and manufacture of components for the growing data communication/computer markets.

Foreign competition continued to erode the firm's market; during 1978 one of the firm's two plants was closed when foreign interests purchased the domestic consumer T.V. manufacturer which had been purchasing the total output of that plant.

When assistance began in 1979, employment was at 137 persons (down from 165 in 1976); all of these jobs would have been lost without Trade Adjustment Assistance. Units of production had declined from approximately 622 thousand units to approximately 324 thousand units.

As a result of Mid-America Trade Adjustment Assistance Center's Diagnostic Review and Economic Recovery Plan an EDA guaranteed loan was made in February of 1980 providing greatly needed fixed asset and working capital financing. Without Trade Adjustment Assistance this firm would have been put out of business by imports.

The Mid-America Trade Adjustment Assistance (through the competitive-bid process) arranged for a consultant which designed a new product from an existing product line (a magnetless flyback - a flyback is used in CRT's, T.V.'s and other electronic video display devices). This new product was of the magnitude that a major firm, Atari, bought Amplifone. The new owner has expanded employment by 23.3 percent to 212 persons; sales have increased substantially and are expected to be up by 50 percent by mid-year over last year.

Type of Trade Adjustment Assistance
Consultant Assistance: $67,000

Firm Name:	Stevie Togs, Inc.
Address:	3527 Broadway Kansas City, Missouri 64111
Telephone:	816/531-4333
Contact:	Mr. Sam Greenstein, President

Stevie Togs, Inc., an apparel manufacturer with production facilities in Parsons, Kansas, had for 30 years manufactured children's apparel, with emphasis in the boys' jeans line. Imports of children's apparel made significant inroads into Stevie Togs' markets. Consequently, the firm applied for Trade Adjustment Assistance in September, 1980.

Stevie Togs' principal management had begun investigating the ladies' wear markets. Mid-America Trade Adjustment Assistance Center (TAAC) engaged an industry consultant to review Stevie Togs' operations and to investigate the feasibility of the firm's moving into the women's wear market. The study clearly showed that the firm should drop the boys' jeans line and move into fashionable ladies' sportswear.

The firm's financial condition was sound enough to enable it to finance required capital expenditures without outside assistance. Significant assistance in production and in supervisory retraining was required to assure a smooth and successful transition during the change of its principal product lines. A competitively-bid consultant contract was executed by Mid-America TAAC to provide the required assistance. The firm shared 25 percent of the cost of the technical assistance.

Cost-savings has been estimated by the consultant to be $115,000, and this figure is presently being documented. Employment at the time service began was 151 persons which was down from the 219 persons the firm employed prior to the adverse effect of imports. Sales volume has remained stable even in light of the deletion of the existing line, and Stevie Togs expects sales to show increases in the next year.

INFORMATION OBTAINED
FROM PUBLIC SOURCES

Type of Trade Adjustment Assistance
Direct Loan: $1,000,000
Guaranteed Loan: $3,000,000
Product Development Asst.: $10,000

Firm Name: Billy the Kid, Inc.
Address: 4171 N. Mesa, P. O. Box 9817
El Paso, TX 79988
Principal Product: Boyswear and other apparel lines

Billy the Kid, Inc. was founded in 1937 and has developed into a leading boyswear manufacturer. The firm experienced healthy increases in net sales until 1978 when sales began to decline due to the impact of imports on most apparel lines.

In 1979, the Mid-America TAAC began to assist the company by examining the firm's operations. From this initial assessment, it was determined that the firm needed to develop a business plan to reverse their declining sales levels and remain a viable company.

It was determined that an outside consulting firm who specialized in the apparel industry should be retained to evaluate the firm's operation and recommend appropriate solutions. A competitive analysis was also conducted to assess the firm's relative standing in the apparel industry and to assess any potential opportunities for diversification.

The investigation revealed that sales could be significantly increased through diversification into related apparel lines, and profit margins could be widened through the implementation of a company-wide cost reduction program. To enable the firm to successfully implement the recommended strategies, a $3 million guaranteed loan for working capital and a direct loan of $1 million for fixed assets was requested under the Trade Act of 1974.

In February, 1981 the requested financing was received. As a result of the technical and financial assistance obtained through the Trade Adjustment Assistance Program, net sales for the 39 weeks ended June 27, 1981 rose 18 percent, year-to-year, reflecting gains in unit volume and higher average selling prices due to changes in the product mix. Aided by a company-wide cost reduction program, margins widened and pretax income surged nearly 2-1/2 times. After tax earnings increased to 37.6 percent from 22.5 percent a year earlier, while net income nearly doubled to $2.08 million from $1.05 million during the same time period.

For the fiscal year ended 9/26/81, net income advanced 59 percent to $2.9 million, compared with $1.8 million a year earlier. Revenues totaled $111.0 million, up 20 percent from the $92.5 million generated during the same time period a year earlier. Aggressive expansion is continuing in domestic markets as well as in export sales to Europe, Japan and South America.

Type of Trade Adjustment Assistance
Technical Assistance: $275,000
assistance in production scheduling
Direct loan: $1,000,000

Firm Name: Osceola Shoe Co.
Address: 9475 Crompton Road
Osceola, AR 72370
Telephone: 501/563-6594
Contact: Mr. William Page, Jr.

Osceola Shoe Co. formerly manufactured houseshoes. Their market was decimated by Taiwanese and Korean imports; therefore, late in 1979, the firm sought Trade Adjustment Assistance.

A review of the firm's operations disclosed that the firm, through significant adjustment in its marketing approach, could feasibly penetrate the market for casual shoes and for golf shoes. Also, the firm could regain a significant competitive edge through obtaining its raw materials in greater quantities and through improvements to its production scheduling. Osceola Shoe Company's working capital had been impaired from its loss of market share, so the firm applied for a direct working capital loan under terms of the Trade Act of 1974 (since private sector financing was not available to them) and entered an agreement to share in the cost of the production assistance to be provided under the terms of this same act.

The services of a major accounting firm were obtained under contract to develop the marketing plan and also to develop, install and refine a computer module to be used in production scheduling late in 1980. Consultant performance spanned all of calendar 1981 and is entering its final performance stage. The firm also took advantage of export opportunities presented through the Trade Adjustment Assistance for Industry program.

During the course of involvement in Trade Adjustment Assistance, the firm's employment increased from an average of 500 persons to approximately 650 persons or by 30 percent. Since the firm's production facilities are located in the delta farmland area of Arkansas, the impact in terms of diversification of employment opportunities in an agri-based economy cannot be overstated. Concurrently, its sales increased by 43 percent in calendar 1981 as compared to 1980, escalating from $14 million to $20. Substantial improvements were achieved in net profits during this same period.

Osceola Shoe Co. has historically shared half the cost of assistance provided under the Trade Act of 1974. In these final assistance phases, the firm is paying 100 percent of the required subcontract consultant cost associated with custom programming of software. As a result of the Trade Adjustment Assistance received, this firm is a healthy, viable employing unit in the communities in which it is located.

Type of Trade Adjustment Assistance
Guaranteed Loan: $375,000
Marketing Assistance: $6,500

Firm Name: Fairfax Mfg. Co., Inc.
Address: Hwy 59, P. O. Box 218
Fairfax, MO 64446
Telephone: 816/686-3381
Contact: Mr. James H. Hunter, President

Fairfax Mfg. Co., Inc. is a manufacturer of small wood products, principally gift items for men consisting of pipe racks, ashtrays and dresser valets. In 1975, its product line was copied by the Taiwanese and imported into the United States. These imported products were retailed at approximately one-half the price of Fairfax's products due both to the labor advantage enjoyed by the Taiwanese and also to the fact that the Taiwanese had no costs associated with the development of designs since they copied the products.

From 1975 through 1979, the imported products captured half of Fairfax's domestic market share. Consequently, Fairfax's employment decreased from 60 persons to 19. In October, 1979, Fairfax petitioned for eligibility to apply for Trade Adjustment Assistance. The firm was certified. Mid-America Trade Adjustment Assistance Center assisted the firm through the performance of a diagnostic review of its operations and the preparation of an economic adjustment plan which identified areas of financial and marketing assistance necessary to effect the firm's adjustment to its loss of market share to foreign imports.

The firm received approval of a $375,000 loan, guaranteed under terms of the Trade Act of 1974. Shortly thereafter, the firm's plant site was flooded. The firm was closed for six weeks while the flood damage was repaired. Without the financial assistance, the firm would not have survived the ravages of both a flood and of import impact. As production resumed, an outside consultant was engaged by Mid-America TAAC to provide in-depth assistance to the firm in the area of marketing. This assistance enabled the firm to diversify its product line and to enter the premium market. To date, the firm's sales have increased more than 25 percent--and they continue to increase. The firm's employment has stabilized at 20 persons.

Type of Trade Adjustment Assistance
Production Assistance: $124,800
for improvements in manufacturing,
data processing and management.

Firm Name: Tobin-Hamilton Company, Inc.
Address: Mansfield, Missouri 65704
Telephone: 417/924-3223
Contact: Mr. Joseph Guccione

Tobin Hamilton Company, Inc. is a manufacturer of athletic footwear. Imported shoes were beginning to capture an increasing share of its markets. The firm applied for Trade Adjustment Assistance in the latter part of 1979.

An initial review of the firm's operations revealed that in order for the firm to become more efficient and thereby more competitive, new plant layouts were required at both of its plants, and the warehouse system needed to be restructured. Improvement was needed in the operations of the firm's data processing system, and assistance was necessary in its organizational planning and development.

Mid-America Trade Adjustment Assistance Center (TAAC) executed a competitively-bid consultant contract for the services to be provided on a cost-shared basis to the firm, and the scope of work outlined above was accomplished.

Since entering the program of Trade Adjustment Assistance, the firm's sales increased from $10.5 million to $18 million. Its employment increased from 314 persons to more than 600 persons. The investment of approximately $100,000 in funds under the Trade Act of 1974 for the provision of adjustment assistance to this firm has been richly repaid in terms of increased productivity, increased competitiveness, increased employment and increased tax base.

WESTERN TAAC ENGAGEMENT SUMMARY

Fishing Pole Hardware Manufacturer   Marketing and Production

Background

This manufacturer of fishing pole components and accessories, after a history of gradually increasing volume and profits for over 30 years, started to show a sharp downtrend when impacted by imports from the Orient in 1977. Volume receded from $2,300,000 to under $1,500,000, while employment was reduced from over 80 to under 30 workers.

Objectives

Western Taac perceived that the firm would have to find outlets for its capabilities in areas other than fishing poles, since this appeared to be a dying domestic industry. An outside production engineering consultant was engaged by Western TAAC to evaluate the firm's machinery and equipment and to help determine in which markets the firm might have a viable place.

In addition, Western Taac was asked to evaluate the feasibility of the firm's entering the aluminum anodizing field, either for its own products or as a contractor, or both.

Furthermore, it was determined by Western TAAC that a new product line would have to be developed to make optimum use of the firm's facilities.

It was also observed that outside financing would be required to enable the results of these findings to be implemented.

Components of the Engagements

The production engineer determined that the firm rightfully belonged in the job-shop business and set about identifying suitable areas for pursuing this direction.

The Western TAAC staff made projections of cost and performance factors associated with entering the aluminum anodizing field.

Western TAAC engaged an outside consulting firm to identify new products suitable for the firm to manufacture as proprietary items.

Fishing Pole Hardware Manufacturer, cont.

Summary

As results of the application of Western TAAC resources to the problems confronting the firm-

- The firm was enabled to bid successfully for job shop work in the aerospace industry, including being accepted as eligible from the point of view of Quality Control.

- Because it was determined that entry into the aluminum anodizing field was not likely to be cost effective, the firm was saved the probability of losing substantial sums of money and the loss of valuable executive time in a fruitless endeavor.

- The outside consultants engaged to identify new products did, indeed, identify more than a dozen viable products, some of which the firm will very likely manufacture in the near future.

- Western TAAC helped the firm secure an SBA loan of $375,000, which has been instrumental in enabling the firm to reach its objectives.

As a further result of this assistance, volume is now beginning to pick up and the work force is up to 40 persons. The company is firmly established in the job shop field and is finding increasing acceptance for its work. Negotiations are proceeding with the respective inventors and/or their representatives for manufacturing the identified proprietary items under license.

Western TAAC Engagement Summary

Personal leather goods manufacturer

Plant feasibility
Information systems
Marketing and Finance

This firm is a smaller family owned leather goods manufacturer with sales in the $2 million dollar range. The products include high quality wallets, check book covers, purses and key cases for both men and women. Products are sold through better department stores and luggage specialty shops.

Because of the father's old-world leather craftsmanship training the product competes favorably with the best personal leather goods on the market today no matter what the country of origin.

In addition to price competition from off-shore products this firm was also experiencing the same dificulties that all firms experience as they transcend the dividing line between entreprenuerial start-up and higher volume production.

The manufacturing area although well organized was at capacity for the existing space.

Production control and inventory control were also at the upper limits of capacity for the manual information systems that were being used.

And finally, the marketing activities were proceeding in a haphazzard sell-where-it-could-be-sold manner.

Objectives

The objective of this engagement was three-fold as follows:

1. Find alternate ways of expanding production space and examine the feasability of each
2. Locate or design an information system that would handle the Company's requirements during their next phase of growth
3. Develop an organized strategy to marketing that would orient the Company's thrust in the same direction thus complementing and building on each achievement

Western TAAC assisted these companies on all three fronts by arranging for consulting assistance in each area.

Results

1. The feasibility study determined that a new plant should be built on land adjacent to the existing plant if financing could be obtained at a certain rate of interest. If not, a work flow reorganization would be necessary until that interest rate was available.

   Western TAAC is presently in touch with several state and community assistance programs to obtain appropriate financing.

2. The requirements of an information system have been identified and the Company is presently accepting proposals from various suppliers based on these requirements.
3. A marketing strategy task has been responded to by several qualified consultants and the Company is in the process of deciding on one.

The Company is looking forward to operating in a much more efficient manner at the conclusion of each of these projects and anticipating continued steady growth over the long term even in the face of potent import competition.

WESTERN TAAC ENGAGEMENT SUMMARY

Jewelry Manufacturer **Marketing, Production and Design**

Background

Annual sales for this manufacturer of costume jewelry rose from $32,000 in its first year, 1961, to a peak of over $800,000 in 1977, when import competition began to be felt. In 1978 sales fell to $425,000, and employment went from a high of 35 to a low of 6.

It seemed apparent to management that a rapid departure from costume jewelry, which had been almost entirely taken over by offshore manufacturers, into karat jewelry was strongly indicated. But this area, too, was being invaded increasingly by Italian, Israeli and Far Eastern firms. The client wished to enter the field of artificial diamonds in gold settings.

The firm did not have the finances to do a marketing study to determine the viability if this step.

Objective

A diagnostic study of the firm by Western TAAC revealed that there was a need for funding, a change in the product line and improvement in the design of any line, improved production engineering and a better understanding of its marketing problems.

Components of the Engagements

Western TAAC engaged the services of the country's leading jewelry consultant to determine the feasibilty of the articial diamond field for the client. They also obtained the services of consultants in production and design. In addition, the Western TAAC staff analyzed the results of the feasibility study as it applied to marketing, and hired a financial consultant to help with the preparation of the client's Loan Application.

Summary

The results of these engagements indicated that the firm's intended entry into the artificial diamond field was not only feasible, but well timed and likely to succeed. The designs of the mountings were greatly

Jewelry Manufacturer, cont.

improved. The machinery was improved by the addition of inexpensive attachments, and the workers were better trained to utilize the machines to their fullest capacity.

The firm obtained a direct loan from EDA for $250,000 and their cash flow subsequently changed from negative to positive.

Sales volume increased to the million dollar annual level. Employment doubled within a short period, and the firm reached a profit mode for the first time in several years.

Table 1

HANDBAG PRODUCTION, IMPORTS, AND EXPORTS: 1967, 1972, 1977-1980

(Quantity in 1,000 Units; Value in 1,000 Dollars)

Year	Domestic Production 1/		Imports 2/		Exports 2/		Apparent Domestic Market		Imports As A Percent Of Domestic Market	
	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value	Quantity	Value
1967	97,000 3/	312,100 3/	39,560	44,938	1,037	2,276	135,523	354,762	29.2	12.7
1972	90,100 3/	344,400 3/	67,180	86,890	665	1,562	156,615	429,728	42.9	20.2
1977	55,800 4/	436,300 5/	92,764	207,062	1,135	4,560	147,429	638,702	62.9	32.4
1978	62,700 6/	531,500 7/	138,892	310,382	2,240	9,570	199,352	832,312	69.8	37.3
1979	52,800 6/	518,000 8/	120,356	299,806	3,170	10,949	169,986	806,857	70.8	37.2
1980	53,500 6/	559,000 8/	143,711	350,562	4,227	15,480	192,984	894,082	74.5	39.2

1/ U.S. producers' shipments.
2/ Department of Commerce data. Imports from FT-246 and FT-135. Exports from FT 410, includes exports of parts under item 807.
3/ Based on data in Census of Manufactures; 85 percent of value data for both 1967 and 1972 also had quantity data. Unit value for these data was applied to remaining value data to get total quantity.
4/ Estimated based on available quantity data for plastic handbags in the 1977 Census, increases in the wholesale price index for leather, and the estimated increase in average unit values of other handbags since 1972.
5/ Based on data from final 1977 Census of Manufactures.
6/ Estimated based on increases in the wholesale price index (producer price index beginning March 1978) for "other leather and related products."
7/ U.S. Department of Commerce data in the Annual Survey of Manufactures.
8/ Estimated by Department of Commerce in 1981 U.S. Industrial Outlook.

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GROUP NUMBER I-3021

IMPORTS

HANDBAGS

	MONTH OF DEC		- - JANUARY TO DATE - -				MONTH OF DEC		- - JANUARY TO DATE - -		
	QUANTITY	VALUE ($)	QUANTITY	VALUE ($)	VALUE 81/80		QUANTITY	VALUE ($)	QUANTITY	VALUE ($)	VALUE 81/80
CANADA	2,134	65,385	43,176	872,184	.062	MEXICO	33,979	193,581	486,929	2,708,218	1.074
GUATMAL	0	0	5,566	16,641	4.623	SALVADR	1,500	7,805	1.564	8,511	5.414
C RICA	0	0	25	286	.817	PANAMA	0	0	83	332	1.145
BAHAMAS	0	0	719	2,605	*	JAMAICA	0	0	20	255	.589
HAITI	144,686	482,094	2,021,672	6,323,958	1.815	DOM REP	154,894	696,590	1,725,743	7,637,138	.921
LW WW I	0	0	30	746	*	BARBADO	0	0	1,616	3,033	9.419
N ANTIL	0	0	350	5,231	*	F W IND	360	738	360	738	*
COLOMB	26,740	344,387	394,841	4,893,345	1.178	GUYANA	0	0	1,468	591	.537
F GUIAN	0	0	36	1,455	*	ECUADOR	327	3,524	1,946	16,218	1.769
PERU	360	582	1,220	12,242	.387	BOLIVIA	62	1,048	1,528	15,594	1.381
CHILE	0	0	846	16,558	4.553	BRAZIL	55,337	432,920	766,703	6,013,218	1.268
URUGUAY	8,551	108,521	183,821	1,680,100	.631	ARGENT	0	0	5,101	84,825	.397
SWEDEN	384	3,999	2,854	17,093	.948	FINLAND	129	5,572	4,334	54,214	1.195
DENMARK	2,088	8,947	3,849	29,930	.312	U KING	1,811	11,035	42,144	355,609	.745
IRELAND	0	0	1,276	15,658	27.374	NETHLDS	0	0	4,151	16,726	1.891
BELGIUM	0	0	2,082	9,021	1.469	FRANCE	12,050	337,966	133,002	3,685,359	1.024
W GERM	707	44,494	18,878	615,242	1.919	E GERM	0	0	48	886	.055
AUSTRIA	0	0	191	7,158	6.454	CZECHO	0	0	35	1,565	*
HUNGARY	2,854	76,220	16,809	300,358	2.576	SWITZLD	96	2,433	7,454	82,567	.769
POLAND	0	0	8,642	122,952	1.574	SPAIN	30,047	321,310	391,206	3,389,339	1.492
PORTUGL	0	0	283	4,068	4.205	ITALY	335,093	3,397,051	2,621,364	41,033,900	1.027
YUGOSLV	0	0	98	630	.057	GREECE	1,372	9,481	4,904	35,010	1.179
TURKEY	1,083	17,631	3,062	40,186	25.466	CYPRUS	0	0	461	4,605	.508
SYRIA	496	4,666	496	4,666	.283	LEBANON	7,212	46,231	266,502	1,631,840	.898
IRAN	0	0	42	556	1.154	ISRAEL	0	0	2,025	2,771	.171
JORDAN	0	0	25	333	*	S ARAB	0	0	4,000	5,000	*
YEMEN A	0	0	3,700	14,500	*	AFGHAN	0	0	2,970	9,374	.963
INDIA	32,540	144,196	864,359	2,852,746	1.084	PAKISTN	0	0	1,714	4,901	.786
NEPAL	0	0	960	1,128	.335	BNGLDSH	0	0	4,316	5,808	1.350
SRI LKA	0	0	4,184	2,348	.319	THAILND	712	3,019	34,547	94,272	.871
LAOS	0	0	2,232	3,348	.214	MALAYSA	988	3,044	4,905	13,106	12.364
SINGAPR	1,202	5,544	16,372	34,119	6.385	INDNSIA	500	395	10,398	20,871	40.137
PHIL R	302,457	592,617	2,307,054	4,248,963	1.231	MACAO	61,298	102,662	460,888	1,002,364	1.270
SO ASIA	0	0	600	1,692	*	CHINA P	795,864	1,593,421	9,480,783	17,425,527	6.852
KOR REP	1,109,348	4,842,908	17,344,669	71,211,543	1.183	HG KONG	2,781,356	5,405,043	32,540,280	67,566,152	.965
CHINA T	8,802,001	14,529,725	95,835,740	153,112,121	1.196	JAPAN	180,922	424,434	1,610,313	5,302,452	1.650
AUSTRAL	0	0	363	13,101	1.301	N ZEAL	0	0	1,591	8,659	1.614
O PAC I	0	0	228	1,580	1.934	MOROC	34,049	88,399	490,396	1,372,649	.804
EYGPT	0	0	7,353	51,624	.150	CAMROON	0	0	140	298	*
IVY CST	0	0	74	600	*	GHANA	0	0	66	676	*
KENYA	1,728	11,704	6,377	34,730	1.351	MALAGAS	0	0	705	409	*
REP SAF	84	9,796	837	37,371	.476						

	MONTH OF DEC		- - JANUARY TO DATE - -		
	QUANTITY	VALUE ($)	QUANTITY	VALUE ($)	VALUE 81/80
TOTAL	14,729,368	34,381,118	170,224,712	406,230,294	1.159

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TESTIMONY
OF CHARLES W. WEIKEL
BEFORE THE COMMITTEE ON THE BUDGET
UNITED STATES SENATE
MARCH 26, 1982

Good morning. I am Charles W. Weikel, President of KMNCO, Inc. (pronounced "KENCO"), located at 16410 Stephens Drive, East Detroit, Michigan 48021. I am here this morning to tell you briefly about the impact of imports on KMNCO and what assistance we requested and received under the Trade Act Assistance Program. I will briefly review the following areas:

1. A description of our business
2. The circumstances which caused us to apply for assistance
3. What assistance we have received and its value
4. Our view of our future

I would like to state initially that the directors and officers of KMNCO agree with the objectives of the Administration and many in Congress to control government expenditures, particularly to reduce budget deficits as a means of controlling inflation, reduce interest rates and put the economy on a sound basis again. We recognize that the difficult decisions which this Committee must make involve differentiating between programs that may be desirable but which may not be equally effective or useful in achieving the realistic goals required today. Such decisions require both knowledge of the facts and wisdom. I hope my comments today will be helpful in your deliberations.

1. Description of KMMCO's Business

KMMCO is a family-owned business. It was founded in 1940 as a supplier of automotive exterior trim to the major automobile manufacturers in Detroit. Until the late 50's trim was almost exclusively chrome-plated steel. Today it is mostly aluminum or vinyl covered aluminum and steel. It takes the form of the body side mouldings, window trim, rocker panels, wheel opening trim, head light bezels, etc. We manufacture the product to the specific design of the manufacturers mostly on large presses, roll form machines and metal bending machines. Additional processes in our plants include painting, anodizing, welding, buffing,etc.

Our customers in order of sales volume are General Motors, Ford, Chrysler, Volkswagen of America and others with about 98% of our sales dollars automotive. Our best year was 1979 when our sales were $31 million, our peak number of employees was about 1000 spread between our plants in East Detroit, Michigan; Pontotoc, Mississippi; Clanton, Alabama and Atlanta, Georgia. In 1979 we supplied about 20 percent of the OEM automotive trim market.

We have been affected both directly and indirectly by imports. Directly by a Canadian company that has moved aggressively into the U.S. automotive trim market and with the help of favorable wage rates, Canadian government assistance and other lower costs have been able to under-bid KMMCO and our U.S. competitors consistently. We have been affected indirectly also by the well-publicized flood of automobiles made in Japan, which, of course, arrive in this country fully assembled and with no need for domestic suppliers of trim.

Our current level of business is $16 million a year--about half of 1979's sales level. The automobile industry is in a depression which started over 18 months ago. Foreign built trim and automobiles are major causes of that depression and caused us to close our Mississippi facility in November 1981. Since 1979 we have been forced to terminate the employment of approximately 500 people in this and other locations.

2. Application for Assistance

KMMCO applied for assistnace under the Trade Adjustment Act in the late Spring of 1980. A diagnostic analysis under the auspices of the Midwest Trade Adjustment Assistance Center was made of our entire operation including a proposed major diversification into a process called structural foam plastics. We viewed this opportunity as an excellent diversification for us and the TAAC diagnostic analysis confirmed our conclusions.

The structural foam industry is a billion dollar industry in the U.S. today, growing rapidly during the past several years. This growth is expected to continue. One of it's most practical and cost-effective applications is in housings for office machines such as photocopy machines, typewriters and computer cabinetry and one literally can see these products everywhere, everyday. The potential applications for structural foam seem almost limitless and are being developed daily by the industry. Such applications involve the replacement of labor-intensive, cost-ineffective assemblies and complex parts of metal or other material.

3. Assistance Received

While KMMCO was able to hire experts and do detailed planning in the field of structural foam the devastating effects of the automotive depression considerably weakened KMMCO's financial ability. Three million dollars was required and KMMCO was unable to find that amount through conventional banking sources. Again, the Trade Adjustment Act came to our aid and with the assistance of TAAC a presentation was made to the Economic Development Administration first in Chicago and then in Washington for a $2.3 million loan guarantee. Our application was approved in January and finally closed in July 1981 giving us the $3 million dollars necessary to finance the venture.

Since Janaury KMMCO has built three state-of-the-art structural foam machines to our proprietary design and are in production today producing cabinetry for the Burroughs Corporation in Detroit. In the weeks immediately ahead KMMCO will be manufacturing parts for such companies as IBM, Xerox, Pitney-Bowes, Hazeltine, Wang, et al. We look forward to being one of the leaders of the structural foam industry in a very short time. By June 1983 we expect to hire an additional 100 employees at our East Detroit plant and we expect the growth beyond then to be impressive.

Considering the size and complexity of the effort, for a small company like KMMCO, the entire project has gone exceedingly well. Beyond the U.S. market, we have found significant marketing opportunities in Canada and overseas (the first parts we made were shipped to Scotland).

4. Our Future

Encouraged by this strong beginning we are optimistic about our future and our ability to help reemploy U.S. citizens. Again under provisions of the Trade Adjustment Act and with the help of the Midwest TAAC office we are planning a market survey of the European Common Market for both structural foam product and our proprietary presses. The survey will commence within 30 days.

On the metal trim side; our automotive sales seem to have stabilised.. severe cost reduction program is beginning to pay off. Here too TAA has been of help. We took advantage of the technical assistance provisions of the Act and received Midwest TAAC's assistance in analysing our energy usage (heat and electricity alone cost us $700,000 in 1981). While the exact cost saving is difficult to determine with falling volumes and a plant closing, we believe these costs have been reduced by as much as $90,000 a year. These important savings to our country and company would probably not be realised had it not been for TAA.

Finally TAA provided KMMCO with technical assistance in market research designed to identify possible work we can perform for specific companies and industries in the Southern states. The marketing emphasis focuses on our unique strengths: anodising and metal slitting with the objective of helping us diversify away from the mature automobile industry into new areas of growth. We hope this will strengthen our base and restore our Alabama plant, at least, to the level of employment it enjoyed as recently as two years ago.

That is KHMCO's success story, a result of our direct involvement with the Trade Adjustment Act. We are thankful for its availability. Without TAA and EDA we could not have entered the major diversification of structural foam, would probably not have realised the energy savings we are now achieving, nor done the marketing research and planning necessary to position ourselves for the mid-eighties. Because of the Trade Adjustment Act KHMCO has a very real chance of reversing the employment trend for the company and the communities in which it operates. As I understand, that's what the Act was intended to do.

A STATEMENT ON THE BENEFITS OF TRADE ADJUSTMENT ASSISTANCE

for

The Joy Footwear Corporation
440 W. 27th Street
Hialeah, Florida 33010
(305) 885-9941

Prepared by:

Mr. Humberto Lopez
President, The Joy Footwear Corp.

Submitted to:

The Committee on the Budget
United States Senate

My name is Humberto Lopez, and I am president of The Joy Footwear Corporation, which is located in Hialeah, Florida. I am a native of Cuba and immigrated to this country in 1960. I became a United States citizen in 1967. I attended Georgia Institute of Technology in Atlanta, Georgia, receiving a degree in Industrial Engineering.

The Joy Footwear Corporation was founded in 1971 as a manufacturer of casual footwear and athletic shoes generally made of canvas upper components and rubber soles. We were a relatively successful company and by 1977 had reached $9 million in sales, comprised mostly of canvas basketball shoes. We employed approximately 350 persons.

In the years following 1977, the nylon and vinyl jogging shoe became very popular, and the market for basketball shoes and canvas shoes in declined. Joy Footwear began to manufacture jogging shoes but was unable to attain any degree of success in this market because of the market being flooded with cheaper imports from Taiwan and Korea. Price wise, Joy Footwear was unable to compete with the imports because it lacked the ability from a productivity standpoint to make up the difference between American and (cheaper) foreign wage rates.

By 1979 sales had declined from the 1977 high of $9 million to $4.5 million. Employment was down from 350 to 140. As the result of declining sales and unprofitable operations, the company was financially weak and unable to borrow money in the private sector.

In 1979, Joy Footwear Corporation filed a request for Trade Adjustment Assistance with the Department of Commerce. The firm was certified as eligible to request assistance and did so by requesting help in the preparation of a strategic business recovery plan.

A well-known national consulting firm was provided through the Trade Adjustment program to assist the company in developing a strategy to overcome the problem of import impaction. The consultants audited all company operations to identify the problems and opportunities of the firm. The consultants, together with the management of Joy Footwear, prepared a tactical plan which included the following elements:

1. A consolidation of product lines, with concentrated effort in certain product lines and market segments;
2. An improvement in both the quality and quantity of the sales force;

3. The purchase of production equipment, including two additional injection molding machines, which would increase the plant output to levels consistent with sales projections; and
4. The installation of sewing machinery work aids and revision of the work measurement system to improve productivity and reduce labor costs.

The plan was submitted to the Department of Commerce and subsequently approved, thus allowing Joy Footwear to receive additional technical and financial assistance to implement its recovery plan.

Financial assistance was provided through the Trade Adjustment Assistance Program to support Joy Footwear's strategy. A combination guaranteed/direct loan was approved for $1.75 million to supply working capital for the new marketing strategy and to purchase the new equipment for the productivity improvement strategy. Technical assistance was approved to provide 12 person-months of on- site industrial engineering expertise to restructure the work measurement standards and install machinery work aids.

As a result of the production efficiency program, manufacturing costs were reduced by 15 percent. Some productivity savings were passed along to the employees allowing them to increase their hourly earnings. The technical assistance, together with the new working capital, provided the basis of Joy Footwear's active pursuit of the new jogging shoe market.

Sales for 1981 were $16 million — up from the 1979 low of $4.5 million. The company now employs 600 persons, many female, mostly Spanish-American workers in the Hialeah-Miami area.

Based on my company's experiences, I can testify to this Committee that the Trade Adjustment Assistant Program for firms is a very beneficial program. Today, Joy Footwear is a successful firm, but the battle against imports is not over. Joy Footwear is continuing to experience difficulty in competing with foreign labor. The company needs to continue to take advantage of available computerized stitching equipment that will increase the productivity of our workers.

I believe the Trade Adjustment Assistance Program for firms is a practical, cost effective way to support American industry in adjusting to the free trade policy, and I would like to recommend to the Committee that it be included in the forthcoming budget.

TESTIMONY OF
EDWARD S. LEVY, EXECUTIVE DIRECTOR
NATIONAL HANDBAG ASSOCIATION
350 FIFTH AVENUE (SUITE 510)
NEW YORK CITY, NEW YORK 10118

TEL: 212-947-3424

BEFORE THE

COMMITTEE ON THE BUDGET

UNITED STATES SENATE

THE HONORABLE PETE V. DOMENICI,

CHAIRMAN

Mr. Chairman - members of the subcommittee, my name is Edward S. Levy Executive Director of the National Handbag Association.

I am appearing here today on behalf of the NHA membership and with the full support of my Board of Directors, which consist of 26 men and women who represent a complete cross section of our industry, all price points and every conceivable type of material used in making our product. Reptile, leather, vinyl, fabric, metal findings, zippers, thread, glue and many other products. Yes, a large segment of American manufacturers feed off of the handbag industry.

Some 155 American manufacturers are active members of our fine Association. We also have some 25 contractor and supplier members. Our members have plants from Rhode Island to Florida, from New York to California, from the largest manufactuer doing over 40 million dollars per year to shops doing less than 250 thousand per year. According to the U.S. census, there are some 400 handbag factories in the U.S. today.

Ten years ago, there were approximately 750 establishments producing handbags in the U.S., a decline of 47%. Total employment is now estimated to be less than 20,000. According to Domenic DiPaola, Managing Director of the Leather Goods, Plastics, Handbags & Novelty Workers Union, Local #1, AFL-CIO, its membership has declined 44% from 9,000 to 5,000 workers in the past 10 years.

The decline in U.S. handbag shipments, the decline in U.S. handbag producers, and the decline in U.S. handbag workers can only be attributed to the dramatic increase in handbag imports. Imports have gone from 39,560,000 units in 1967 to 170,225,000 units in 1981; a 435% increase. During that period of time, imports as a percentage of the domestic market increased from 29% to 80%.

The most important factors leading to an increase in imports are the free trade policies of the U.S., which recently led to the negotiated Multilateral Trade Agreement for lower tariffs and the low wage rates in Latin America and the Far East, which enable imports to enter the U.S. market in large quantities at very competitive prices.

The American handbag industry is down, but not out. There would not be an American handbag industry today if it were not for the Trade Adjustment Assistance program. In the Metropolitan New York area, 21 handbag producing firms received financial assistance totaling $14.3 million, preserving 2,325 jobs and estimated to create 2,175 additional jobs in 3 years. Most important is that hundreds of firms received technical assistance to help them adjust to increasing import competition. In addition, many handbag firms have obtained private financial, as well as other types of assistance that would not have been provided if it wasn't for the Metropolitan Trade Adjustment Assistance Center.

After EDA determined that imports were severly impacting the handbag industry, the National Handbag Association received in 1978, a U.S. Department of Commerce grant to fund an "Industry-Wide Recovery Program". This grant supplemented by cash and in kind contributions from the industry was extended for another year in September, 1980. The funds were distributed over 5 specific projects:

1. The design of a cost/price accounting system. This project was successfully completed by Price-Waterhouse, and its how-to manual distributed free of charge to all requests from the industry.
2. The organization of a fashion oriented education program. Coordination with the shoe, scarf, hat, dress, coat, sportswear and textile industries was accomplished. A series of fashion shows was implemented to show the "total look".
3. An extensive market study on consumer and buyer attitudes, including test marketing was performed throughout the U.S. These studies to determine the "lifestyles" of women in different parts of the country is available to all American manufacturers.
4. The development of a comprehensive export manual. That, plus export seminars helped increase the value of handbag exports 36% from 179 to 1980.
5. The National Handbag Association in conjunction with the Leather Goods, Plastics, Handbags & Novelty Workers Union, Local #1, AFL-CIO, the Fashion Institute of Technology and the City of New York established a school to train young talented people to design and make handbags. Only the influx of young people with new ideas and concepts can make the industry prosper. This school is considered a success by all and is now financed jointly by the industry and the unions.

Instead of copying designs from Europe, our handbag industry is now unique in its own right. Our talented designers and makers are now finding their own niche in the industry. There is excitement and hope in the air. Hope for the industry and hope for its workers. Technical assistance for both firms and the industry as a whole, must be increased. Support by this Subcommittee to continue the program is essential for the survival of this hundred year old industry.

SUMMARY

Last year, four out of every five handbags sold in the U.S. were imported. In the past ten years the number of U.S. Handbag manufacturers declined 47% and the number of workers is estimated to have declined 44%.

The benefits received by the Handbag Industry in accordance with Trade Act of 1974, was greatly responsible for its survival. It afforded the industry an opportunity to undertake research, marketing, educational and financial stueies to counteract the adverse affects of ever increasing imports. The results of these studies helped stabilize domestic sales and employment through strengthend internal efficiency, product improvement, installation of cost controls, and improved financial strength. A niche has been found for the American handbag industry. There would not be an American handbag industry today if it were not for the Trade Act of 1974.

RECOMMENDATIONS

The Handbag Industry totally supports the continuation of the trade adjustment assistance program for firms and industries. We believe that increased funding, especially for technical assistance, be provided in the FY 1983 Budget for Firms and Industries as administered by the U.S. Department of Commerce. A logical budget might include only $20 million for loans, but $30 million for the all important technical assistance.

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